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PRINCIPLES OF MARKETING

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PREFACE

The purpose of this book is to treat of the nature of the marketing process, viewing the market structure as a whole and analyzing marketing problems and the devices used in solving them. In doing this I have tried to discuss the most fundamental of the problems and principles involved. Descriptive material has been used when it seemed essential to the illustration of principles, and economic theory has been introduced wherever it would promote the discussion of particular points.

The form of treatment is functional. But sufficient informational material has been introduced, early in the book, to give a background from which to develop the functional approach. With this in view the first two chapters discuss the general nature of marketing and introduce the marketing functions. Chapters III–V discuss the problems, methods, and machinery used in marketing farm products. Chapter VI treats of the marketing of raw materials. Since many of the problems found in marketing raw materials are similar to those involved in marketing farm products, the treatment here is from the buying rather more than from the selling point of view. In the four chapters which follow, the marketing of manufactured products is discussed. Two chapters are then devoted to retailing and one to coöperative distribution. Chapter XIV serves a double purpose. In it is discussed the general topic of the elimination of middlemen, and at the same time it serves indirectly as a convenient summary of previous chapters. This summarization prepares the reader for the discussion of the specific functions and problems which comprises the remainder of the book.

This method of presentation is a development of several years' experience in teaching marketing. First used as lecture notes, these chapters have been revised from time to time and

for the past four years have been used in mimeographed form in my own classes and by instructors in a few other large universities. Because the conditions under which marketing courses are given in colleges and universities are so various that no one form of presentation is likely to prove adapted to all needs, ample cross references are used and some repetition is indulged in. The rather copious footnote references of the earlier mimeographed editions have been largely retained. Such specific references seem to serve better as a basis for collateral reading and class reports, and as a source for lecture material, than do more general bibliographies.

The names of the business men and of others who have helped me from time to time—in conference, and by letter, and with access to confidential information or to information not in published form—are too numerous to give. There are, however, a few to whom I am particularly indebted. All students of marketing are under obligation to the early analyses of market problems made by A. W. Shaw in his "Some Problems of Market Distribution" and by L. D. H. Weld in his article, "Marketing Functions and Mercantile Organization" (*American Economic Review*, June, 1917). I am personally indebted to Mr. Weld for constructive criticism of parts of my manuscript. I wish, also, to acknowledge the help of several others who have rendered special assistance of one kind or another: K. W. Colgrove, R. S. Forsythe, C. E. Griffin, C. O. Hardy, O. B. Jesness, E. D. Jones, W. E. Lagerquist, W. H. Moorhouse, E. G. Nourse, V. H. Pelz, F. A. Russell, and W. K. Smart. My colleague, Professor H. B. Vanderblue, read the entire manuscript in its earlier stages of development, at a time when his careful criticism was most helpful. My greatest indebtedness is to my wife, Carrie Patton Clark, who has assisted at all stages in the preparation of the manuscript and in getting the book through the press.

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PRINCIPLES OF MARKETING

CHAPTER I

INTRODUCTION

Marketing consists of those efforts which effect transfers in the ownership of goods, and care for their physical distribution. The need for marketing grows out of the division of labor, particularly as manifested in large scale production and in the localization of industry. This division of labor, in turn, is due to the diversity of human wants—a diversity which arises not merely from the demand for the prime necessities of life, but from that far greater number of acquired wants which result from the seemingly limitless possibilities for human beings to expand and develop their desires.

Different Interests.—Marketing is engaged in by the producer, the consumer, and certain specialized agencies including those commonly called middlemen. To each of these, marketing appears in a different light: to the farmer, lumberman, fisherman, miner, or manufacturer, it affords a means of disposing of his surplus products and of purchasing the materials, equipment, and supplies necessary to production; to the consumer it affords a means through which desired commodities are made available; to the middleman and other market specialists it affords a source of business income. The attitude of each of the three groups involved in marketing must be understood before the subject can be intelligently approached.

The producer is interested in marketing since it affords the means through which he can sell his product. He wishes to

sell for as much as possible. The consumer, on the other hand, desires to stretch his income as far as possible. He wants to buy for as little as he can. Purely as consumer or as producer neither has a particularly altruistic attitude toward the other. Thus, when the prices of farm products rise the farmer rejoices and the consumer feels aggrieved, but when the prices of farm products fall the farmer grieves and the consumer rejoices. Finally, just as the interest of the producer is to sell at the price which will bring him the largest ultimate profit, and just as the interest of the consumer is to buy at that price which will make his income go farthest, so the interest of the middleman and the other specialists of the market is to sell their service, the marketing of products, for the highest net return.

It is evident, then, that the market process involves interests which conflict. But since no one is in all his relations to the market always in a single class, his interests differ from time to time. Each individual is likely to be in at least two of these classes, since most people buy and sell. When purchasing goods for consumption, or for use in production, each has the point of view of the consumer; when selling his services or his product, each has the point of view of the producer.

Concentration and Dispersion.—The market machinery of today has been built up about a twofold flow of products. One gathers and concentrates the basic raw materials and food stuffs at central points. The other disperses them toward the ultimate consumer, sometimes in their natural state, but usually after some degree of processing. Not only the products but the forces of demand and supply are concentrated at these central points. The transfer of title between producer and consumer is greatly facilitated by this process of concentration and dispersion, but it often leads to congestion in the physical distribution of the goods. Concentration is usually necessary even in the distribution of products sold in their natural state. This is true whether they be raw materials of

manufacture or commodities consumed in their original form. It is also common in the marketing of some manufactured goods which are used as production goods by other manufacturers. Concentration, particularly of farm products, usually involves two steps. One is preliminary concentration near the source of production, by means of which the products of numerous small producers are gathered together in larger quantities. The other involves the concentration of these products by the large dealers in central markets. From these central markets the products so concentrated are then dispersed to manufacturers, in the case of raw materials, and to other dealers for further dispersion, in the case of products ready for final consumption.

The process of concentration and dispersion is by no means uniform with all products. For instance, some farm products are shipped directly from producers to central points, from which they are then dispersed, with or without further processing, toward the ultimate consumer. Others are first collected at local markets, and are then sent to the central markets. Sometimes merchandise is dispersed in large quantities from central markets to smaller markets and from there distributed to consumers. Sometimes it goes directly from central market to consumer. Many products pass directly from producer to consumer. The great majority of products are first concentrated as raw materials and then dispersed as manufactured products.

Diagram I illustrates the point which has just been made. It is impossible, however, to indicate the relative number of producers, consumers, and other parties involved. To do so it would be necessary to show a much larger number of producers and consumers and also of middlemen who deal most directly with them, such as country shippers and retailers.

A Market.—At each point where a specific commodity is concentrated for sale a market is found. This is true whether it is being concentrated for further concentration, for dispersion, or, as often happens, for both purposes. Indeed, a market

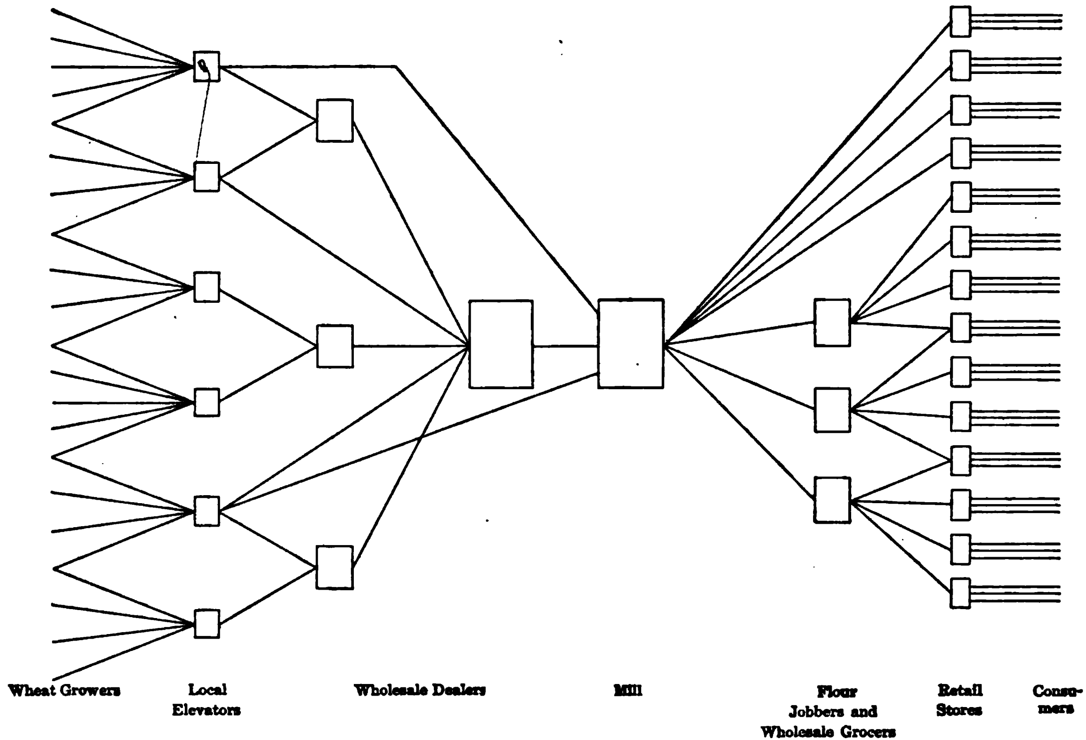


DIAGRAM I.—Concentration of Wheat and Dispersion of Flour

always exists unless the step is controlled by a single business man. In that case no change of title is involved.

A market is, then, a center about which the forces leading to exchanges of title operate, and toward which and from which the actual goods tend to travel. It leads to clarity of thought to bear these two aspects of market structure constantly in mind; i. e., that the market structure is built about two processes: the transfer of the title to goods from producer to consumer, and the physical transfer of the goods themselves. But the physical presence of the goods is not essential to a market, for the distinguishing characteristic of a market is the fact that transfers of title take place therein.[1]

Channels of Distribution.—The methods by which this dual transfer of goods and title is carried on vary greatly. In consequence, many channels of distribution are found, the nature and form of which depend on the nature of the product, the conditions of its supply and demand, and the development of market technique. By the term "channel of distribution" is meant primarily the course taken in the transfer of title. The transfer of the goods themselves may or may not be through the same channels. In some cases title to goods is passed several times while they are en route or in storage. But ordinarily the goods themselves pass along the same channel as does the title.

Classes of Middlemen.—Title may be transferred through direct purchase and sale between the producer and the consumer. This is frequently true of raw materials sold to manufacturers and of goods sold in large quantities by one manufacturer to another. On the other hand, title may be transferred to the final purchaser only as a result of the activity of one or more middlemen who may, or may not, hold the title themselves. Middlemen are, in fact, sometimes classified on the basis of their relation to the transfer of title. Those who buy goods outright, and thus take title, are merchants.

[1] For a discussion of the relations between different markets for the same commodity, see pp. 435–439.

Those who assist directly in bringing about the transfer of title, but who do not themselves take title, are functional middlemen of exchange. They are functional middlemen because they specialize in the performance of a single market function—the transfer of title. Their efforts are directed, primarily, toward expediting or making more convenient the exchange of ownership. But they do not take title to the goods as does the merchant. Retailers, jobbers, and wholesale receivers are the most common of the merchant class. Brokers, selling houses, and commission men are common examples of functional middlemen of exchange.[2]

A third group of market agencies, sometimes called functional middlemen, should also be distinguished.[3] They are individuals, firms, and corporations, specializing in the performance of a part or all of the work involved in some one type of market activity. Railroads, public warehouses and cold storage plants, inspectors and graders, banks, and insurance companies, are common examples. Such agencies serve producers, middlemen, and consumers in a specialized capacity. They are not, however, properly called middlemen, because that term should denote direct assistance in the transfer of title.

An important distinction can likewise be drawn between middlemen who are engaged primarily in concentrating products and those who are engaged primarily in dispersing them. Middlemen for the dispersion of products are particularly essential in the distribution of consumption goods. Jobbers and retailers occupy an especially important position. The former assemble products from manufacturers and concentrating middlemen. Then they disperse them to retailers, who in turn disperse to the consumer. Whereas middlemen who concentrate products tend to specialize in handling one particular

[2] The advertising agency could well be classed here. All of its activities are directed toward demand creation, and in addition it acts as a space broker.

[3] See A. W. Shaw, *An Approach to Business Problems*, pp. 160–163.

product or very similar ones, dispersing middlemen usually handle a wide variety. Thus, local shippers to some extent, and central market receivers to a large extent, handle grains alone, or fruit and vegetables, or butter and eggs, or live stock, or perhaps even a single grain, one fruit, eggs, or cattle, alone. Jobbers, on the contrary, tend to handle a wide range of commodities, the range depending in large part on the needs of the retailers whose wants they supply. There are, accordingly, grocery, green goods, meat, hardware, dry goods, and drug jobbers, just as there are groceries, fruit and vegetable stores, meat markets, hardware, dry goods, and drug stores.

Classes of Goods.—Notwithstanding the fact that all production is guided by the wants of the ultimate consumer, large volumes of goods are not desired for personal consumption. In fact, three important classes of goods can be distinguished:

1. Goods for personal consumption
2. Production goods: materials to be further processed, which consist of
   - *a.* Raw materials in their natural state
   - *b.* Semi-manufactured goods
   - *c.* Completely manufactured parts—to be assembled
   - *d.* Supplies
3. Equipment for use in production and distribution.[4]

The production of goods for personal consumption is the final aim of the productive process.

[4] To the economist the creation of utilities, such as those of substance, of form, of time, and of place, is production. Thus, in the cotton industry the creation of substance utilities is involved in the work of the plantation on which the cotton is grown; form utilities are created in the various factories in which the raw fibre is manufactured into cloth; place utilities are created by the transportation agencies involved; and time utilities are created at any point at which materials or the final products are stored. It will thus be seen that the creation of time, place, and possession utilities is included in the process known as production. In the text, however, the term "production" will generally be used in the narrower sense which excludes these activities and includes

Production goods may eventually reach the status of goods ready for personal consumption, they may be partially or completely consumed in producing other goods, or they may be processed into equipment and supplies. There are four important classes of these production goods: (*a*) raw materials in their natural state, such as coal, iron ore, wool, cotton, wheat; (*b*) semi-manufactured goods which must be further processed by those who use them, such as pig iron, leather, flour, cotton "in the grey"; (*c*) manufactured products which will receive little or no further processing themselves but which are to be assembled with other products, such as cloth, buttons, bolts, screws, and automobile parts; (*d*) supplies, such as oil, stationery, and coal used for power. Supplies are goods which are used to assist production or marketing, but which do not become a part of the final product. These could be considered as a fourth general class. Their merchandising characteristics, however, warrant including them as a subclass under production goods.

The third class of goods—equipment—is used by producers and dealers in expediting production and marketing. These goods seldom become the object of further exchange. Such capital assets as office furniture and equipment, factory machinery and power plants, should be included here.[5]

A particular product may serve different purposes. Consequently, its place in this classification may change with the uses to which it is put. Coal, for example, should be classed with consumption goods when used by the householder, with production goods when used in the production of coke or coal

only the creation of substance and form utilities. The terms "marketing" and "distribution" will be used synonymously. This use of the terms "production" and "distribution" accords with well accepted usage in the field of industry and makes for clarity in discussion.

[5] For a somewhat similar classification see M. T. Copeland, "The Scope and Content of a Course in Marketing," *Journal of Political Economy*, Vol. XXVIII (May, 1920), pp. 375–398, reprinted as Part I of his *Marketing Problems*, pp. 2–3. See also P. T. Cherington, *Elements of Marketing* (1920), Chap. II.

gas, or in the generation of power. But most products fall either ~~in one group or another, and even such products as~~ coal, which are in more than one group because they have several uses, will be subject to conditions of distribution which vary with the use to which they are to be put. Since the conditions of distribution vary with the different classes of goods it is essential to keep this classification in mind when, from point to point in later discussions, these variations are discussed.

CHAPTER II

THE MARKETING FUNCTIONS

It is necessary now to return from this brief summary of the nature of marketing to the definition of marketing which was given in Chapter I. It was indicated there that there are two important aspects of marketing. The first consists of the process of buying and selling, by means of which transfers in the ownership of goods are effected. This is the central fact of modern distribution. The second aspect of marketing concerns the physical transfer of the product from producer to consumer.

The Marketing Functions.—In the process of transferring ownership two important functions—demand creation (selling) and assembly (buying)—should be distinguished. These are, in reality, complementary functions leading up to and accomplishing the transfer of title, but the purpose of each is different. The purpose of selling is to find a market in which the seller's available product can be sold at a profitable price. The purpose of assembly is to procure for the consumer at a satisfactory price the variety, quality, and quantity of goods which he desires, and to have them ready for his use at the proper time and place.

The functions which effect the physical transfer of products from producer to consumer are transportation and storage. Transportation involves the moving of products from their sources to the place of consumption; and storage involves the holding of products from the time of their production until the time of their consumption.

Three other functions are essential to marketing: financing, risk-taking, and standardization. The first two may be called

the "ownership" functions,[1] since their presence in the form in which we know them is due to the recognition of property rights. Standardization involves the arrangement of goods into groups determined by the size, quality, and quantity the market demands.

Outline I. The Marketing Functions[2]

A. Functions of Exchange
   1. Demand creation (selling)
   2. Assembly (buying)
B. Functions of Physical Supply
   3. Transportation
   4. Storage
C. Auxiliary or Facilitating Functions
   5. Financing
   6. Risk-taking
   7. Standardization

Each of the marketing functions is so important that it calls for separate and detailed discussion. In the present chapter, however, only the exchange functions—demand creation and assembly—will be discussed at length. The others will be introduced, but their more thorough analysis will be undertaken in Chapters XV, XVI, XVII, and XIX.

[1] See Homer B. Vanderblue, "The Functional Approach to the Study of Marketing," *Journal of Political Economy,* Vol. XXIX, No. 8 (Oct., 1921), pp. 676–683.

[2] This plan for presenting the marketing functions follows rather closely that outlined by L. D. H. Weld, in an article entitled "Marketing Functions and Mercantile Organization," which appeared in the *American Economic Review,* Vol. VII (June, 1917), pp. 306–318. I have also been assisted by the outline of functions found in Nourse, *The Chicago Produce Market,* pp. 129–131.

A. W. Shaw has outlined the "middleman's functions" with particular reference to manufacturer's marketing. He gives the following: sharing the risks; transporting the goods; financing the marketing operations; selling or creating demand; and assembling, assorting, and reshipping the goods. See his *An Approach to Business Problems* (1916), p. 157. P. T. Cherington, in his *Elements of Marketing* (1920), Chap. I, has adopted a grouping of the functions which corresponds closely to the one here presented.

Demand Creation.—The first essential to marketing a product is to bring seller and buyer in touch with one another. For no matter how great may be the desire of the one to sell and of the other to buy, no exchange can take place until each knows of the desire of the other. Moreover, many goods are not specifically desired by consumers, but must be brought to their attention, and a desire for the goods may even have to be created before they will be purchased. For products catering to the fundamental needs for food, fuel, and clothing, and generally utilized in meeting such needs, a universal demand exists; it is already created through the elemental and acquired wants of the individual. From this it follows that for the materials and for the machinery and supplies used in the production of these staple products, a demand likewise exists. There are other goods of which this is not true, and the creation of a demand for these is of prime importance to their producers. Such articles are sometimes called "specialties," and in general are luxuries or convenience goods.[3] They not only serve to gratify the primary needs, but also cater to those refined tastes which improved economic conditions have made possible to large numbers of the consuming public.

Improvements in production during the past century have lowered the costs of production of necessities and created a surplus of purchasing power for many individuals. This surplus above that needed by the consumer for the purchase of essentials need not be spent for any particular commodity or class of commodities. With the elemental wants gratified it may be spent for conveniences and luxuries.[4] Inasmuch as

[3] C. C. Parlin, *The Merchandising of Textiles,* pp. 5–6 (quoted in note 28 on pp. 222–223.

[4] "There is a drift toward a better quality of merchandise. From Maine to California, from Duluth to New Orleans, retailers asserted that the tendency to buy better goods is evident. This does not mean a tendency to buy extreme top-price articles. . . . But the drift toward quality means that there is a general lifting up of the lower grades of merchandise toward a medium or higher quality."—C. C. Parlin, *The*

there usually exists at a given time the capacity for producing more conveniences and luxuries, as well as more staple commodities, than the purchasing public is able or willing to buy at a price which will net a profit to the producers, it is evident that the sale of any individual producer's goods may depend primarily upon the success with which a demand has been created for them. There arises, then, a competition among producers of such articles, and each must bring his commodity to the favorable attention of prospective customers. A similar situation faces the producer of services. The typical retail merchant is an example. True, there is a demand for retail service in general, but any particular retailer could be eliminated with no great social loss. Hence each must create a demand for his particular services.

The foregoing discussion makes it clear that the consumer can usually exercise an independent choice of the goods and services he will consume. This fact often forces even the producers and merchandisers of commodities which gratify fundamental needs to compete for his patronage. This is illustrated by such commodities as branded flours. Flour caters to elemental wants, but an especial attempt is made to create a demand for each particular brand. Such products are sometimes called "branded staples," and the method of their sale indicates that the process known as demand creation is not confined to conveniences and luxuries. Even when the consumer knows that he needs an article and knows that he can buy it, he frequently requires a little encouragement before he will take the final step and make the purchase.

What Is Demand Creation?—But just what is demand creation? Its purpose is to control the direction of demand. The process consists in carrying ideas, or selling points, about a product or service from the seller to prospective purchasers.[5]

Merchandising of Textiles (1915), pp. 32, 33 (published by the National Wholesale Dry Goods Association).

[5] See A. W. Shaw, *An Approach to Business Problems*, Chap. VIII. The term "demand creation" is used here because it has been widely

There are three distinct methods of doing this. One is through (1) the satisfaction derived from the use of the article itself. If the consumer has tried a product and likes it better than others he will buy that product the next time he needs one like it, provided the price is satisfactory. A second method is (2) through personal solicitation by salesmen. The third consists (3) of the use of advertising, by means of the written or printed word, pictures, diagrams, and symbols. The use of samples is sometimes considered as an independent method, but this is not correct, for they must be used in conjunction with personal solicitation, or advertising, or both. All of these methods are commonly used conjointly. The satisfaction derived from the product itself is not usually considered as a result of marketing effort, but rather as a result of good production. Good production, however—particularly of luxuries and conveniences, and to some degree of staples—is commonly due to a careful analysis of the needs and desires of consumers, which is a part of the marketing process.

Modern Emphasis of Demand Creation.—The creation of demand has probably always been associated with marketing, but it has become a peculiarly important feature of the modern system. This is particularly true of the marketing of goods for personal consumption. Increased power in production has brought on the market, either actually or potentially, a larger number of products than the public has been in the habit of consuming. Some of these are staple products, some are luxuries, and some are products new to the consumer. For staples

adopted. In many cases the phrase really expresses a wish rather than an actual result. For it is often true that real demand is not created as a result of any particular efforts, such as the producer's. Rather the buyer is placed in a favorable frame of mind toward a product by the efforts of the producer, but—if middlemen appear, or if the buyer does not purchase at once—later events must determine whether the favorable impression which has been created can be turned into demand. The ease with which a retailer can often divert to a substitute product the favorable impression created by national advertising is an illustration of this point.

and luxuries favorably known to the consumer a desire already exists, and the problem of the producers and merchandisers thereof is to sell their particular product in competition with others. But for new products, or for products desired by but a small number of consumers, little or no general desire exists. This is true despite the increased power in production, which has brought these products on to the market, and which has resulted in, and been accompanied by, an increased purchasing power in the hands of buyers. For the effect of the increased purchasing power as manifested in effective demand tends to lag behind the increased power in production; and there is, consequently, a constant tendency toward general overproduction, as well as toward overproduction in individual lines.[6]

The Rôle of Demand Creation.—This possibility that individual producers will make more products than the public will utilize of its own volition, or even more than it can purchase, gives point to demand creation. It becomes necessary for individual producers to create demand when that is possible—not only that their products may not accumulate on their hands, but also that they may utilize their capital in money, machines, and materials, as well as their time, to the best advantage. For it is the province of demand creation to make the public buy more of the things it is accustomed to consume, to purchase other products than is its habit, to buy one article in preference to another or several others of the same general kind, or to patronize one vendor rather than another.

Another factor in the growth of the effort directed toward the creation of demand is the desire of many producers to increase their sales, with a view to selling even more goods than the immediate needs of their organization as a going unit demand. But why? First of all is the mere desire for a large volume of business. In America in particular there

[6] Overproduction means that there are more goods on the market than will be bought at remunerative prices.

seems to have developed an eagerness to become the "largest" in town, city, country, or world.[7] This may prove incentive enough for demand creation. It arises from the ambition for power and the esteem of one's fellows. But back of the effort to create a demand for products is almost invariably found the need or desire of the seller to increase or fortify his profits. If his sales are large, certain results are likely to follow. His gross receipts will be greater, and the unit expense of producing, or selling, or both, may decline with the enlarged volume of business. For example, the reduced cost of selling and of production per unit which follows the increased demand stimulated by advertising, in many cases more than offsets the cost of the advertising.[8] Again, increased sales tend to bring a greater degree of control over the market. And this in turn may give to the producer more of monopoly power, or at least a stronger position in the industrial and commercial world, thereby reducing certain market risks, such as the risk of competition. Finally, the expansion of his market which results from successful demand creation fortifies the seller against local variations in the demand for his product, variations which might prove disastrous if his market were confined to a single locality.

Assembly.—The assembling activities of marketing are complementary to demand creation. Their purpose is to bring

[7] "Possibly the chief influence in the long run in promoting combinations of capital, as well as their most far-reaching effect, is the element of personal ambition which is fostered by monopoly."—J. W. Jenks, *The Trust Problem* (1900), p. 73.

[8] Some hypothetical cases will illustrate these points:

	Volume of Business (in units)	*Unit Cost of Production*	*Unit Cost of Selling*	*Total Unit Cost*	*Unit Price*	*Unit Profit*	*Total Profit*
Case 1—	100,000	$0.50	$0.25	$0.75	$0.80	$0.05	$ 5,000
* Case 2—	200,000	0.50	0.25	0.75	0.80	0.05	10,000
* Case 3—	200,000	0.50	0.27	0.77	0.80	0.03	6,000
* Case 4—	200,000	0.50	0.24	0.74	0.80	0.06	12,000
* Case 5—	200,000	0.45	0.30	0.75	0.80	0.05	10,000
* Case 6—	200,000	0.40	0.30	0.70	0.80	0.10	20,000
* Case 7—	300,000	0.40	0.20	0.60	0.80	0.20	60,000

* Increased sales efforts have been exerted in these cases.

commodities together where they are wanted for immediate use in production or in personal consumption. The goods which the ultimate consumer and the producer desire come from scattered areas of production. They are produced not only in the country or district in which he resides, but in distant areas and foreign lands as well. These products, to be available for use, must be assembled at convenient points in the volume and variety required.

What Is Assembly?—Assembly should not be confused with transportation and storage. For whereas these are functions of physical distribution, assembly involves judgment. What products will consumers need? In what quantities? How rapidly will they be consumed? Where can they be obtained? Were it not for our marketing machinery each individual, family, dealer, and factory would need to answer these questions unaided. Their needs could not be met as now through daily purchases, but only through planning far in advance, sometimes for years, and through keeping in touch with the producers of desired articles and with those who transport and store them. But today the average consumer, or even the average manufacturer, goes to a middleman and purchases what he wants. Most commodities are available on short notice because of the activities of a number of specialists who make it their business to judge in advance what the nature and volume of demand will be, who keep in constant touch with sources of demand and supply, and who order the goods far enough in advance of final demand to have them ready for use.[9]

[9] "The term 'assembling,' as here used, does not mean the actual physical transportation of commodities from one place to another, but rather the seeking out of sources, the making of business connections whereby commodities may be bought, and the study of market conditions so that they may be bought at the lowest price possible.

"Assembling therefore involves all the services connected with *buying*."—L. D. H. Weld, "Marketing Functions and Mercantile Organization," *The American Economic Review*, Vol. VII (June, 1917), p. 307.

The final process in assembly is, of course, that in which the consumer brings together the things which he desires to consume. But back of him there may have been a long line of assemblers—retailers, jobbers, commission men, manufacturers. Looked at from the point of view of the consumer the work of all these, as well as of the agencies preceding the manufacturer, is to assemble and prepare commodities for final consumption. The consumer looks chiefly to the retailer for these commodities, and the chief function of the retailer is to assemble them for him. But the retailer, in turn, looks to the jobber, the manufacturer, and the commission man, for the goods he handles. They assemble for him. The jobber in particular plays an important part in this process. The grocery jobber, for example, assembles the hundreds of varieties and brands of goods which come from all parts of the world, and makes them available to the retail store.

Assembly by Manufacturers.—Manufacturing plants do some of their own assembling. They are, consequently, assembling indirectly for those who later buy the finished product of their factories. The automobile is an assembled product in this sense, as well as in the manufacturing sense. Even the manufacturers of automobiles who make most of their own parts assemble some parts, and perhaps all of the accessories and equipment. Tires, speedometers, lighting systems, tops, wind shields, wheels, axles, springs—some or all of these are bought ready to install even by the largest manufacturers. Many cars are assembled almost entirely from parts made by other manufacturers. Furthermore, the production of most of these parts involves the assembly of equipment, supplies, raw materials, and semi-manufactured products at the factory. Assembling by manufacturers may also be more direct. For example, some producers of a particular part of a "line" of goods purchase or handle on consignment the related products of other manufacturers. In this manner they are enabled to handle a "full line" of goods, with the advantages in selling which a complete line sometimes carries with

it. Moreover, their overhead expenses may thus be spread over a greater volume of sales. Lumber manufacturers who own their own retail yards usually handle other building materials; tool manufacturers and manufacturers of machinery frequently handle related but non-competing products made by other firms.

Sometimes the manufacturer's own purchasing department searches out the sources of the materials needed. This is particularly true of large establishments and of those which have difficulty in finding the particular kind of raw material they need. But many manufacturers depend upon middlemen to do this work for them. Few, if any, buy all their materials, supplies, and equipment directly from the producers.

Concentration and Dispersion a Part of Assembly.—The process of concentration and dispersion, mentioned in the first chapter, is a part of the work of assembly. But assembly is the more complex process whereby the numerous kinds of products demanded are made available to the user in the required qualities and quantities and at the proper time and place; whereas concentration and dispersion have to do with the marketing of individual products. Apples, for example, which are produced by small growers in different parts of the country, may be concentrated at central markets, from which they are dispersed to ultimate consumers. This process is, nevertheless, a part of assembly, for such goods are being assembled, along with other products, for the convenience of consumers. It is evident that the same process may be concentration or dispersion from one point of view and assembly from another. Diagram II illustrates the concentration and dispersion of a few products, and shows their relation to the process of assembly.

Transportation and Storage.—The physical distribution of products consists in the highly specialized and technical activities involved in transportation and storage. It is a commonplace of industrial history that improved transportation makes possible large markets, large scale production, and specializa-

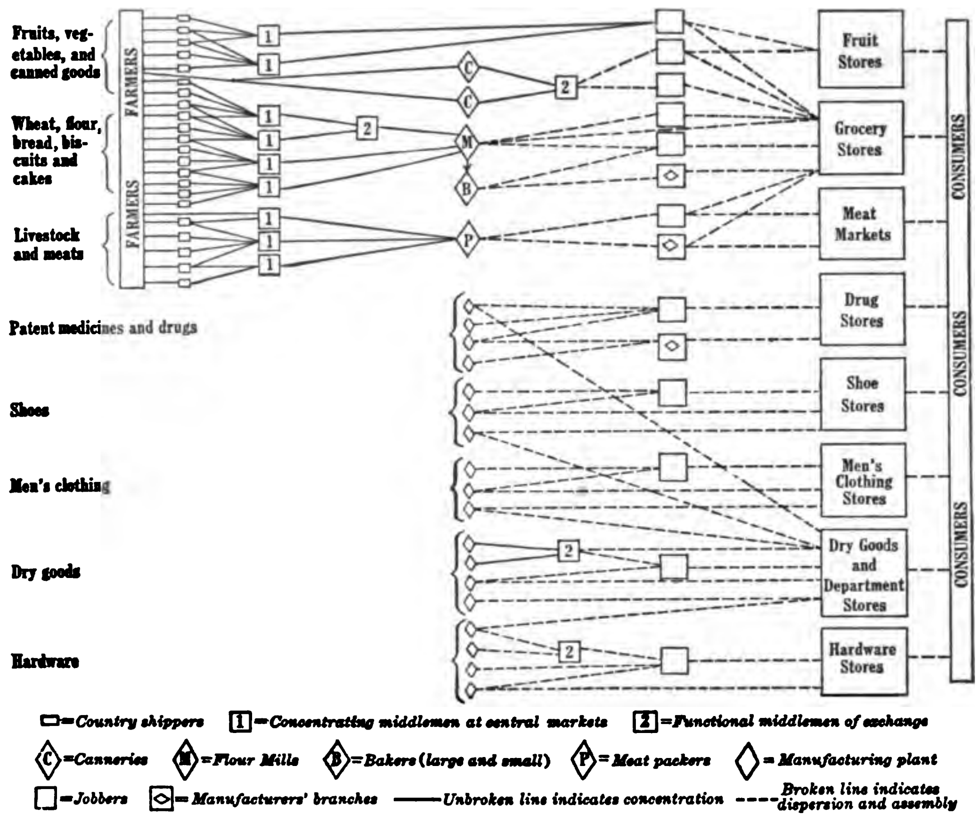


DIAGRAM II.—Concentration, Dispersion, and Assembly

tion in industry; that it has increased the variety of goods available for consumption, and has reduced the cost of their physical distribution. The chief function of physical distribution is to take goods from the place in which they are produced to the place in which they are to be consumed. This is called the "creation of place utilities," and is the function which transportation systems perform.

Storage, likewise, is essential to commerce. The majority of products are produced "for the market," and not to fill explicit orders. This is particularly true of agricultural products and of many raw materials. But it is also true of manufactured products; for the ultimate consumer—from whom the final demand for all goods comes—seldom orders goods far enough in advance of purchase for them to be made on order. Even with custom-made goods only the final fashioning of the product is ordered by the consumer. All preceding production—even though made on order—is for the market in the sense that the final demand of the ultimate consumer is an unknown quantity—a demand which often falls short of expectations so far as particular products are concerned, and sometimes for products in general. In addition to these considerations is the further fact that it is desirable to have a surplus of most products at hand. This is necessary to protect against slow deliveries and to be prepared for unforeseen increases in demand. Dealers in particular must stock goods to meet such contingencies. Again, many products, particularly agricultural products, are not only produced for the market, but become ready for use during short periods of the year. Such goods must be stored and kept in condition until the time of reduced production, if they are to be available for consumption at all times, and if the large supplies which mature during a short time are to be profitably sold.

The foregoing discussion shows the necessity for storing products at various points between the prime producer and the ultimate consumer, and indicates its importance to industry. Storage involves the technical processes of warehousing

and finance. The latter is a separate marketing function which will be discussed at a later point, but warehousing now warrants a word.

Warehousing.—The technical problems of warehousing are many. They involve the maintenance of suitable facilities for handling and conditioning products, as well as provision for adequate storage space. In addition to this the rules and regulations laid down by boards of trade, and by state and Federal acts providing for the supervision of storage facilities, must be carefully observed. A special type of warehouse has been provided for keeping such products as butter, eggs, and meat in proper condition. Storage is likewise an adjunct of transportation. Perishable products, for example, deteriorate rapidly while en route to market if they are not kept at the proper temperature. Even the ordinary milk wagon must have refrigeration facilities during the warm months.

Financing.—Modern marketing requires vast resources in machines, materials, land, and men, and vast quantities of goods must be held in storage for future use. To meet these demands of our economic system the control of funds is necessary, and it is the means by which these funds are supplied which is called financing. A familiar situation is found in the case of the man who is fitted for running a retail store but who is without funds. At the same time there are others who have funds but lack the time, the desire, or the ability to undertake the project. Means have been developed to bring these together. In many lines of business there are seasonal peaks during which much larger sums are needed than in other seasons of the year.[10] Firms so engaged must be possessed of large financial resources in order to meet these recurring periods. Or, being without sufficient capital, they must seek accommodation elsewhere. In yet other cases, business men

[10] See Morris A. Copeland, "Seasonal Problems in Financial Administration," *Journal of Political Economy*, Vol. XXVIII (Dec., 1920), pp. 793–826.

may accumulate, or could accumulate, sufficient resources to meet all such peak loads, but they may prefer to invest their accumulations in extensions of the business, or even to invest elsewhere. Otherwise such surplus funds can be utilized to advantage only a part of the year and may remain in the bank drawing no return, or a small return, for the remainder of the time. To meet such problems as these is the function of financing.

Risk-Taking.—The whole marketing process by means of which goods are taken from producer to consumer involves risk. This risk is assumed by those who take part in marketing, and particularly by those who take title to goods. There is risk of loss from fire, flood, storm, theft, deterioration; from bad debts or general financial difficulties outside the control of the individual. Styles may change or the market may be misjudged, leaving unsalable products in the hands of those who hold them. Increased supplies, reduced demand, or changes in the value of money may change the prices of commodities. Some of these risks can be wholly or partly insured against, or the burden can be shifted to the shoulders of those who specialize in bearing them. With many others, however, the business man must himself contend. They are the irreducible risks of marketing. The means by which these risks are insured against, shifted, and borne, is an important phase of marketing.

Standardization.—The standardization of merchandise has been called an auxiliary function because it is essential to effective exchange of title and is important to effective transportation and storage. It is in its relation to the methods of transferring title—to bringing about a sale—that standardization compels the greatest interest. This is because the manner of sale of a product depends in part on the extent to which it is known to be of uniform quality, size, and type, and the extent to which these characteristics conform to recognized standards. The importance of standardization to marketing can be better grasped, consequently, after an analysis of the

bases on which sales are made. And since this analysis is of itself important to an understanding of later discussions it will be inserted at this point, even though the detailed discussion of standardization is postponed to a later chapter.

Bases of Sale.—There are three fundamental bases of exchange: sale in bulk, sale by sample, and sale by description.[11] Where goods are sold in bulk, good, fair, and indifferent are taken as they come, as when a "farmer's car" of potatoes is purchased, coal is bought by the "mine run," or eggs by the "case count." But such sales are commonly made after a more or less careful inspection of the actual products to be bought has been made by the prospective purchaser—in which case they may be designated as "sales by inspection." Sale by inspection is found in many purchases at retail, as when the housewife goes to the grocery store to buy fruits and vegetables, or when clothing is purchased for individual wear. In these cases, the particular article to be purchased is seen and inspected by the purchaser.

Sale by sample implies that the bulk of the product can be adequately represented by a sample taken more or less at random. This implies also that the products run or can be made to run true to sample, and that the purchaser has faith in the ability and intention of the seller to deliver goods like the sample. The sample is seen before the goods are purchased or delivered; the buyer purchases from it, and expects the goods he buys to be like it. Samples may be presented by the seller for the purchaser to choose from, or the purchaser may present a sample to indicate what he desires. In either case, the final products may be inspected to determine whether they conform with sufficient exactness to the sample. Many manufactured products sold through salesmen to retail

[11] See also Homer B. Vanderblue, "The Marketing Function of Advertising," in *Advertising and Selling* (June 5, 1920), pp. 16–18, and A. W. Shaw, *An Approach to Business Problems* (1916), pp. 105–109.

stores are purchased from samples, and bulky articles, such as furniture, are frequently sold to consumers from samples on the retail floor. When goods are purchased because they have given satisfaction in the past, which is the method of buying most consumption goods, they are really bought by sample. A method called "sampling" is also used when a "sample" of the delivered product is taken from the bulk and analyzed before the sales price is determined. In such cases the basis on which payment is to be made has been determined in advance. But on delivery it must be determined in what degree the product fulfills the conditions previously agreed upon. Sugar beets are sold on the basis of their sugar content, and ores are sold on the basis of their metal content, as determined after such a sample has been made.

Sale by description is made by word of mouth or by means of symbols, printed and written words, blue prints, and specifications. The description is really a specification on the part of the buyer as to what he will purchase, or on the part of the seller as to what he has for sale. This method implies that the party endeavoring to describe a product can describe it in a manner which will enable the other party to the exchange to understand his description. It implies in addition, as with sale by sample, confidence in the ability and intention of the seller to deliver goods like the description. Of sellers' descriptions the mail order catalogue and advertising are good examples; plans for a house, factory, or machine, are examples of buyers' descriptions.

All these methods may be combined in the sale of a single product. When household utensils—washing machines, electric sweepers, fireless cookers—are sold, they are sometimes sent to the home for trial. If a sale is made the article sent is kept. This is sale in bulk, but it has probably been preceded by advertising which led the housewife to go to this store and see a sample demonstrated—sale by description and by sample.

Outline II. Methods of Sale

- Bulk
  - Bulk ("as is")
  - Inspection
- Sample
  - Seller's sample
  - Buyer's sample
  - Products in use
- Description
  - Seller's description
    - personal salesmanship
    - advertising
    - symbol or trade name
  - Buyer's specifications
  - Grade names—representing standards determined by governmental authority, custom, or associated action.

The Nature of Standardization.—Sale by sample and most sales by description rest upon the standardization of products.[12] These methods of sale are possible only when the buyer is certain that the conditions of production are such that goods can be delivered like the sample or like the description. This condition prevails throughout most modern manufacture, and consequently large-scale standardized production has made possible not only sale by sample, but the enormous expansion of sale by description through the use of salesmen and advertising. Advertising in most of its forms is too expensive to use, unless the single advertisement can be made to describe a product which can be duplicated enough times to meet all or a large part of the demand which is created, and sold in sufficient volume to warrant the advertising expense. A further economy in the sale of standardized products results from the fact that a buyer may purchase in large quantities after simply seeing a sample, or hearing or seeing a description. For if confidence inheres in the intention

[12] Many "want ads," such as those advertising houses and household furniture for sale, are exceptions. A single article is there described, whereas most efforts to sell by description endeavor to sell many similar articles. The actual sale, however, in the case of the "want ad" may be completed only after inspection.

and ability of the seller to deliver goods like the sample or description, each individual part of a purchase need not be inspected. The sale of raw materials, and of goods bought by retail stores, is greatly facilitated when these methods of sale are used. Purchase by brand at retail on the part of the final consumer has the same advantages, and results from the same considerations.[13]

Grading.—An important adjunct to standardization is grading. Grading involves the division of products into classes made up of units possessing similar characteristics of size and quality. In so far as products are standardized in their production, grading is unnecessary, or at most it involves simply the determination of the grade of products which are already of uniform size and quality. Some goods are produced under conditions which make them all of the same size and quality; consequently they all conform to a given standard, and no assorting is required. This is usual with manufactured products. But when goods as produced are not of uniform quality and size they must be sorted into groups which are. Raw materials in particular are not uniform as they come from the field, forest, and mine, whereas the manufacturing plants utilizing them usually demand uniform materials conforming to certain standards.[14] This demand for standardized materials on the part of manufacturers is one of the chief causes for grading raw materials. But even consumers commonly prefer standardized products. When these products are branded with the mark of the producer or distributor, or when they are sold by grade, the consumer is enabled to purchase by description and is thereby saved from uncertainty and the need for inspecting each purchase. He knows that each product he buys will be like the last.

Summary.—Marketing consists of buying and selling and of physical distribution. Under modern conditions an extensive machinery for purchase and sale is found, a machinery

[13] See p. 403.

[14] The reasons for this will be discussed in Chap. VI.

which involves the function of demand creation (selling) and the function of assembly (buying). Physical distribution consists of the technical functions of transportation and storage. And somewhere products must be sorted into classes determined by their nature, size, and quality. This function is called standardization. The control of funds is also essential. This has led to the development of the function called financing. Finally, throughout the whole marketing process the risk of ultimate financial loss from many possible sources must be borne.

CHAPTER III

MARKETING FARM PRODUCTS[1]

The farm is an important source of raw material for manufacture. But many farm products are ready for personal consumption without processing in any way, or at least with but slight change from their original state. The existence of these two classes of farm products—production goods and consumption goods—makes it necessary to keep clearly in mind that the marketing of some agricultural products involves a process for placing them in the hands of manufacturers, and that from this point their distribution is a problem of the manufacturer's market. Products of this nature must be distinguished from others, the distribution of which involves transferring them to consumers in their original form.[2]

I

Characteristics of Agriculture.—Agriculture, in contrast with a prevailing tendency in manufacture, is a small scale in-

[1] There is a sizable literature dealing with the marketing of farm products. Among the more accessible are the publications of the U. S. Department of Agriculture and of the State Agricultural Experiment Stations. Recently the Federal Trade Commission has issued several reports relating to farm products. Among the more valuable books may be mentioned L. D. H. Weld, *The Marketing of Farm Products;* G. G. Huebner, *Agricultural Commerce;* E. G. Nourse, *The Chicago Produce Market;* Theodore Macklin, *Efficient Marketing for Agriculture;* and B. H. Hibbard, *Marketing Agricultural Products.*

[2] In the discussion to follow, raw materials for manufacture, whether the product of the farm, forest, or mine, are frequently considered together, regardless of source. But if the classification on page 7 is kept in mind no confusion should arise in the mind of the reader.

dustry; and unlike manufacture, it is carried on by scattered producers located far from the great body of consumers. Thus the main output of shoes in this country is confined to a relatively small number of factories located in the midst of dense populations, but the hides for the leather used in their manufacture are obtained from cattle raised upon thousands of farms and ranches in the United States and in foreign countries. Even in the manufacture of flour, an industry in which large scale methods are not so predominant, there are dozens, perhaps hundreds, of farms growing wheat to each mill grinding it into flour.

On the other hand, specialized production—which is also a characteristic of manufacture—has become characteristic of agriculture. In fact, the development of specialized production has gone so far that the self-sufficing farm of a former day is no longer found.[3] Each farm produces for the market and must exchange its surplus for the surplus of other farms, and for the output of factories. The products from one agricultural section or from one farm must, consequently, be distributed to the people on other farms and in other agricultural sections as well as to factories and to consumers in populous centers. The grain of the Dakotas supplies the mills of Minneapolis, Buffalo, and Rochester. The stock of the Mountain states moves east to the packing plants of Omaha and Chicago and west to supply the Pacific coast, Alaska, and Hawaii. The fruit of Southern California moves north to Washington and finds its way into the Dakotas, the corn belt, and eastern markets. The cotton of the South moves north and the corn of Illinois and Iowa moves south.

Variation of Marketing Methods.—The marketing problem is not the same for all products. Perishable fruits and vegetables must be consumed or processed almost as soon as harvested. And since they are highly perishable, facilities

[3] See Ellen Churchill Semple, *American History and its Geographic Conditions* (1903), pp. 369 ff.

must be provided to carry them from the farm to table or factory quickly and without deterioration. But most farm products are not so perishable. Furthermore, they are more largely raw materials to be sold to mills and factories than products ready for personal consumption. Wheat and other cereals, live stock, cotton, wool, and tobacco are altered before they are finally consumed. With these, other problems are important, such as, for example, warehousing over long periods of time, and the provision of capital with which to carry the stored commodities. Even a single kind of product is usually marketed in a number of ways through the addition or elimination of steps. Fruit and vegetables may be sold directly by the grower to the housewife or canning factory, but California oranges are sometimes most effectively marketed through five middlemen, each representing a separate link in the market chain. Again, a large volume of agricultural staples is sold directly to factories and mills; but grain is usually sold to the local buyer, thence to the central market dealer, and by him it may be sold to a mill in a city outside the central market or to a dealer in another city, and so on. The same dealer frequently sells to different classes of customers and in different markets, as determined by the offers he receives and by the prevailing prices. Cattle are often sold to country buyers, who consign them to commission men, who sell them both to buyers representing the great meat packers and to other commission men who are buying for farmers engaged in fattening stock for market. But many cattle are sent directly from growers to commission men, others are sold to local slaughter houses, and some are sold directly to the packers. Cotton may be sold directly from the plantation gin to the local mill, or it may go through from one to five or six dealers and finally reach a New England or European mill.[4]

[4] "Cotton is shipped to Great Britain by three classes of dealers: (1) by American shippers, who consign to Liverpool merchants; (2) by

Difficulties in Transportation and Storage.—Farm products are, in general, bulky. That is, the weight is great as compared to the value.[5] This fact makes their transportation and storage difficult and expensive. Bulk is, of course, a relative term; and some of the perishable products, fruits and vegetables in particular, can stand an expensive transportation service because of their high value. Other farm products are less perishable but very bulky, and the cost of transportation plays a larger part in determining their marketability.

Irregularities of Production and Sale.—Most farm crops mature during a relatively short period of the year. Because of this there usually occurs a "peak load" in their sale, storage, transportation, and financing. When not too perishable, they may be held for months in their natural state and so be consumed with more or less uniformity throughout the year. But the farmer often desires to sell at once, sometimes even before the harvest. On the other hand, but few final consumers and but few manufacturing consumers wish, or are able, to store and finance products for their own future use.

buyers sent out from Liverpool and Manchester houses; or (3) by American firms which have a branch office in England.

". . . In Liverpool, with some exceptions, the importer entrusts the disposal of his cotton to a selling broker, and the spinner employs a buying broker. . . . The buying broker and the selling broker each receive a commission of one-half of one per cent on the value of the cotton. In Manchester the importers deal directly with the spinners, not as brokers but as merchants."—Melvin Thomas Copeland, *The Cotton Manufacturing Industry of the United States,* p. 354.

[5] Most agricultural products could not be the subject of extended commerce at all but for the improvements of the past two centuries in transportation. Before the eighteenth century the only articles carried in international commerce were luxuries of great value, but with improvements in ocean transportation products grown near waterways could be carried. It was not until the development of the steam railway that products grown in areas much removed from waterways could be carried far. ". . . In 1817 people were dying of famine in Lorraine, while wheat was abundant in Brittany." But the cost of transportation was too great to bring the supply to Lorraine. See Clive Day, *A History of Commerce* (2d ed., 1917), pp. 318 ff.

There is, consequently, need for storage and financing facilities between the farmer and the consumer. The fact that shipments to central markets are largest following the harvest complicates their transportation; and the financing of this heavy crop movement during the periods of greatest activity is an annually recurring problem of national scope. Table I illustrates the seasonal nature of strawberry production, and Table II shows the large percentage of all grains, and of wheat and corn, which country elevators handled during and immediately following the harvests of 1913 and 1916.

Closely connected with this seasonalness of agricultural marketing is the variation in the amount and quality of the crop from year to year. This tends to disorganize market prices through changing the conditions of supply. The variation in quantity adds to the difficulties of both storage and transportation, for in some years these facilities are taxed beyond their capacity, and at other times they may prove far greater than the need. The variation in quality complicates the problem of grading, and makes purchase and sale more difficult. This is particularly true of raw materials, since manufacturers commonly demand standardized materials with particular characteristics.[6]

Again, there are optional uses to which the farm product may be put. In some growing areas grain may be fed to live stock on the farm, sold to local feeders, or to mills; fruits and vegetables—particularly when not the output of a highly specialized section—may be, in varying degrees, consumed by the farmer, sold as fresh produce to the consumer, or bought by the canning factory. This is likewise a disorganizing factor in the market. Thus if the price of corn is low it may be used for feeding stock, whereas when the price is high it may be sold to dealers. This will affect the market price of corn, and ultimately it will decrease or increase the local supply of live stock and change the demand for substitute products.

[6] See pp. 23–27, 93–96 and 396–398.

TABLE I

Strawberry Shipping Seasons *

District	Shipping Season	Carloads Shipped
Central Florida	Dec. 1–Mar. 31	152.5
Northern Florida	Feb. 10–May 15	378.0
Southern Texas	Mar. 1–May 15	126.6
Southern California	Mar. 1–Dec. 1	373.5
Louisiana	Mar. 15–May 20	1243.0
Southern Mississippi	Apr. 1–May 20	68.0
Northern Texas	Apr. 1–May 20	99.5
Central California	Apr. 1–Aug. 15	1905.0
Central and Southern Alabama	Apr. 15–May 31	294.0
Central Mississippi	Apr. 15–May 31	95.5
North and South Carolina	Apr. 15–May 31	967.3
Northern Alabama	Apr. 15–June 7	100.3
Central and Southern Arkansas	Apr. 25–June 7	505.7
Tennessee	May 1–June 7	1571.5
Virginia	May 1–June 7	779.0
Ozark region	May 1–June 20	748.0
Kentucky	May 10–June 17	84.0
Delaware	May 15–June 20	1374.0
Southern Illinois	May 15–June 20	268.2
Maryland	May 15–June 20	1569.3
Kansas	May 18–June 20	104.8
Central Colorado	May 18–July 15	41.0
Oregon and Northern California	May 18–July 15	277.8
Washington	May 18–July 15	327.0
Southern Indiana	May 24–June 25	103.5
New Jersey	May 24–June 25	248.7
Iowa	June 1–20	21.0
Ohio	June 1–25	15.9
Hudson Valley, N. Y.	June 1–30	122.0
Western New York	June 1–30	54.5
Michigan	June 1–July 15	321.7
Connecticut	June 15–July 15	105.0
Minnesota and Wisconsin	June 15–July 15	66.5
Oswego District, N. Y.	June 15–July 15	13.0
Northern Colorado	July 20–Aug. 31	19.0

* U. S. Department of Agriculture, Bul. No. 237, *Strawberry Supply and Distribution in 1914*, p. 5.

TABLE II

*Total purchases of all grains, and of wheat and corn made in each month of the crop years 1913–14 and 1916–17 by all reporting elevators in the 14 principal grain-producing States**

Year and month	Elevators reporting	All grains		Wheat		Corn	
		Amount	Percentage of total	Amount	Percentage of total	Amount	Percentage of total
1913–14		*Bushels*		*Bushels*		*Bushels*	
July, 1913.....	2,676	24,568,872	8.32	15,344,273	13.31	3,629,191	4.50
August, 1913...	2,974	35,268,911	11.95	13,861,517	12.03	5,508,553	6.83
September, 1913	3,078	38,593,881	13.07	16,722,794	14.51	6,528,426	8.09
October, 1913..	3,065	33,257,567	11.26	16,418,895	14.25	4,491,027	5.57
November, 1913	3,053	27,327,475	9.26	12,666,111	10.99	7,021,239	8.70
December, 1913	3,040	31,613,237	10.71	9,355,226	8.12	13,980,638	17.32
January, 1914..	3,016	23,688,634	8.02	8,031,755	6.97	9,254,542	11.47
February, 1914.	2,978	21,820,223	7.39	6,357,750	5.52	8,836,632	10.95
March, 1914...	2,951	18,091,546	6.13	5,177,869	4.49	6,486,028	8.04
April, 1914	2,787	9,268,253	3.14	3,196,417	2.77	2,947,671	3.65
May, 1914	2,767	16,094,473	5.45	4,153,566	3.60	6,566,131	8.14
June, 1914.....	2,705	15,657,178	5.30	3,967,004	3.44	5,450,760	6.75
Total	35,090	295,250,250	100.00	115,253,177	100.00	80,700,838	100.00
1916–17							
July, 1916	3,891	35,259,044	8.59	17,821,678	13.56	6,719,870	5.73
August, 1916...	4,303	64,079,288	15.62	21,851,662	16.63	7,974,013	6.80
September, 1916	4,489	50,606,007	12.33	19,041,592	14.49	7,641,393	6.52
October, 1916..	4,525	45,770,728	11.16	19,028,516	14.48	4,996,375	4.26
November, 1916	4,428	44,893,388	10.94	13,657,877	10.39	15,505,252	13.23
December, 1916	4,338	31,008,502	7.56	7,079,553	5.39	15,070,382	12.85
January, 1917..	4,390	40,482,911	9.87	9,600,320	7.31	19,253,664	16.42
February, 1917.	4,201	23,594,163	5.75	4,355,027	3.31	11,098,262	9.47
March, 1917....	4,246	22,981,626	5.60	5,992,376	4.56	8,585,186	7.32
April, 1917.....	4,038	16,228,652	3.96	4,910,286	3.74	5,506,643	4.70
May, 1917.....	3,906	19,026,551	4.64	5,065,192	3.85	7,623,051	6.50
June, 1917.....	3,613	16,343,896	3.98	3,016,750	2.30	7,264,456	6.20
Total	50,368	410,274,756	100.00	131,420,829	100.00	117,238,547	100.00

* *Report of the Federal Trade Commission on the Grain Trade (1920)* Vol. I, p. 389.

The Farmer and Marketing.—Other important considerations affecting the marketing of farm products arise out of the characteristics of farming as a business and of farmers as a class. The grower labors under several distinct disadvantages in his attempts to market. He has frequently neither the time, the ability, nor the knowledge to market successfully. He is likely to be particularly busy caring for one crop—plowing, planting, harvesting—just when it may be the most opportune time to market another. And in the winter seasons, when the grower has time to market, country roads are often impassable. Many farmers have slight knowledge of marketing methods and of market conditions, and possess little or no knowledge of the price of their product in other than their own local market. They have even less knowledge of the broad market influences which determine prices. There is often the greatest ignorance of the type of product which consumers are most willing to purchase. Furthermore, the operations of the average farm are on too small a scale to warrant giving much time to marketing, or carrying marketing activities very far toward the final market for which the products are grown.

To meet conditions such as these, coöperation has developed. But here again there is difficulty—the American farmer is highly individualistic and often does not care to coöperate with his neighbors in any marked degree. Furthermore, our farm population is constantly shifting and changing: farm owners go to town or city, and tenants continually change from farm to farm or community to community. And even in the same community there are often different races who feel that they have little in common. Such conditions frequently prove effective barriers to coöperation for the solution of the problems of the agricultural community. More recently, however, the great success of some farmers' coöperative selling organizations has given stimulus to the movement and in large sections of the country the obstacles to coöperation appear to be rapidly disappearing.[7]

[7] See Chap. XIII.

Difficulties with Finance and Labor.—Insufficient funds and lack of credit may hinder the farmer in his marketing just as they often hamper his productive activities. The price of farm products is sometimes lower just at the harvest than long time market conditions warrant. The farmer who can hold his crop may do better later in the year.[8] But many farmers find it impossible to do this. They need the cash with which to pay bills incurred in making essential purchases, or their storage facilities are inadequate. These difficulties have been peculiarly prevalent in some parts of the cotton belt where the small farmers and tenants are notoriously poor. Dependent upon local merchants for credit, they have mortgaged their crops to buy the necessities of life and the essentials of production. The merchants in turn have forced the early sale of the products to themselves and have reaped what benefits there were to be derived from holding the crop. Again the farmer may be able to sell his fruit or vegetables at a better price if they are properly sorted, graded, and packed at the farm, and here likewise the lack of funds may occasionally prove to be the stumbling block which forces him to pass this work on to the middleman.

The lack of labor may also affect the market problem. In the spring of the year, just when the plowing must be done, the price of grain frequently rises; or again the farmer may be unable to harvest, sort or grade his products because of labor shortage. This difficulty is due in part to the lack of funds, and in part to the characteristics of the farm laborer's job; namely, the seasonalness of demand, the social status, long hours, poor living conditions. Whatever the cause, the lack of a sufficient supply of suitable labor is often the source of very real difficulty.

[8] This appears to be the situation with many crops. For those in which future trading is carried on extensively, as wheat, corn, oats, and cotton, it is apparently less true. See J. E. Pope, "Can the Farmer Realize Higher Prices for His Crops by Holding Them?" *Quarterly Journal of Economics,* Vol. XXX, No. 4 (Aug., 1916), pp. 805–831.

Demand Creation and the Agricultural Market.—The discussion in Chapter I indicated that there are two large aspects of marketing: the buying and selling of products, and their physical distribution. In the exchange of manufactured products much effort is devoted to selling. This is particularly true with products used by the ultimate consumer, in the sale of which demand creation is a predominant problem. But in the sale of agricultural products there has been less attempt to influence demand. The resources of the average farmer are too limited and his total production too small to warrant it. Only in the case of commodities like citrus fruits, raisins, apples, cranberries, and milk, which are sold to ultimate consumers, has much effort been made to influence demand, and then only through associated efforts. The great majority of agricultural products are raw materials for manufacture—products bought largely on a basis of specification or grade—in the sale of which demand creation plays no part. These products are in the nature of necessities, a somewhat limited but variable supply of which is called upon to meet a comparatively inelastic demand. It follows that any sales effort which is made is usually an effort of the middlemen who handle the merchandise to sell their service to producers and users, rather than an effort to create a demand for the product itself.[9]

A distinction is sometimes made between agricultural products as goods that are "bought" and manufactured goods as those which must be "sold." But this is not an accurate distinction. If we can generalize at all on this point, it is to distinguish between such goods as raw materials which are bought mainly after careful inspection by the buyer, and on his specification, or on a basis of recognized standard grades,

[9] It should not be inferred that the farmer need not attempt to find the best market for his product. That is an activity in which many farmers could well engage. Seeking the market in which the best price is offered or prevails is a different problem from seeking to create or to influence such a market through efforts at demand creation.

and products in the exchange of which no generally recognized standards of choice exist, and in the purchase of which influence may be effectively brought to bear by the seller. In considering consumption goods it was shown that a distinction is sometimes made between specialties and staples. A distinction between manufactures and farm products is sometimes made on this basis; and the extent to which manufactured products are specialties and farm products staples makes this distinction fairly accurate. But it is not fundamental. For in the case of agricultural commodities which are in the nature of semi-luxuries, which have never been largely consumed, or which come from new production areas, we find that endeavors have been made to create demand. The advertising of California and Florida citrus fruits and raisins, apples from the Northwest, and cherries from Washington, affords examples in point; so do advertised sales of blooded stock and poultry.

The Concentration of Farm Products.—The manufacturing plant which utilizes agricultural products as raw material can usually work effectively only when using the combined product of many farms. And the densely populated areas of the world must, likewise, draw food stuffs from wide areas. To make this possible products must be concentrated in these areas, as well as at manufacturing plants, such as the local grist mill and great milling plant, the sugar mill, the cotton factory, the local butcher shop and the great meat packing establishment. If factories were generally small, drawing their raw materials from nearby and producing for a limited local market, and if population were evenly distributed and willing to consume local products, this would not be difficult. The farmers could haul the raw material to the factory and the finished product could be easily distributed to nearby consumers. Food stuffs, likewise, would be locally grown and consumed. But these are not the facts which condition modern marketing. People congregate in large cities, industries localize, and manufacture is carried on upon a large scale. For physical and economic reasons some farm products can

be grown only in certain districts, which often cover wide areas, far from the centers of manufacture and consumption. Because of the extent of agricultural areas and their remoteness from the consumption points, it is impossible for most farmers to exchange directly with the consumer or even with retail merchants, mills and factories.[10] Thus New England's flour is milled from wheat grown largely west of the Great Lakes, its citrus fruits are grown in California and Florida, the source of the cotton for its mills is in the southern states, the islands of the sea, and Egypt, and many of its meat animals graze upon western farms and ranches.[11]

The Localization of Manufacture.—The manufacture of but few products is evenly distributed among the producing areas from which the raw materials are drawn. Manufacture tends rather to localization in certain districts; and as a general rule an efficient plant can not only produce far more than the local market consumes, but is also likely to utilize more of some raw materials than nearby areas can supply. Extreme illustrations are found in the localization of meat packing about Chicago, the Twin Cities, Kansas City, and Omaha; and

[10] See Map I, p. 47.

[11] "The territory made tributary to the demand of the perishable produce market of the New York zone reaches from ocean to ocean. It even extends overseas to Belgium and Germany for Brussels sprouts, chard, endive, cabbages; to Mediterranean ports for specialties; to Hawaii for pineapples; to Great Britain for potatoes; and it extends south to Central America and the West Indies for bananas, citrus fruits, and a few tropical specialties. A considerable supply of eggs comes from China. Within the continental bounds of North America, New York reaches out to the State of Sonora in northwest Mexico for tomatoes; to southeast Texas and southern Florida for its early lettuce; to Florida and Louisiana for strawberries, new potatoes, and onions; to Georgia and Michigan for peaches, and Colorado and California for melons; to Oregon and Washington for apples; it reaches to the northern confines of Maine for its Aroostook potatoes, to Minnesota for the Red River potatoes, and to the Provinces of Canada for apples, cabbages and onions, butter and eggs."—*Report of the Federal Trade Commission on the Wholesale Marketing of Food* (June 30, 1919), p. 201.

TABLE III

Number of States interested in the markets of 16 cities for specified commodities *

[The figures given for the different markets were furnished by the Department of Agriculture.]

Cities	White potatoes	Sweet potatoes	Cabbages	Tomatoes	Canta-loupes	Apples	Peaches	Straw-berries
	States	*States*	*States*	*States*	*States*	*States*	*States*	*States*
Baltimore	15	3	11	8	9	11	10	5
Birmingham	19	6	16	1	5	21	4	1
Chicago	[illegible]	21	23	21	19	[illegible]	[illegible]	17
Cincinnati	[illegible]	13	17	11	17	22	19	7
Columbus	23	10	10	6	6	16	10	7
Denver	15	8	3	8	4	7	8	2
Kansas City	[illegible]	10	14	4	9	14	12	7
Minneapolis	[illegible]	12	12	11	12	20	13	12
New York	23	8	16	13	15	24	15	12
Omaha	[illegible]	14	13	8	8	12	10	4
Philadelphia	23	4	15	6	8	14	10	9
Pittsburgh	[illegible]	15	[illegible]	20	[illegible]	23	21	17
Spokane	4	..	..	..	2	2	..	..
St. Louis	[illegible]	8	19	13	10	22	15	2
St. Paul	22	7	9	9	9	19	10	8
Washington	14	4	8	7	11	10	9	3
Average	23.81	8.93	13.31	9.12	10.56	16.81	12.12	7.06

* From the *Report of the Federal Trade Commission on the Wholesale Marketing of Food* (1920), p. 48.

in the concentration of the flour milling industry at the middle western termini of railroads and waterways leading east from the great wheat producing areas. The cotton industry, which is localized to a high degree in New England, affords another example.[12] There are, of course, important exceptions.[13] Sugar beets are grown near the factory, although a short rail haul is frequently involved. Canneries draw their fruits and vege-

[12] See U. S. Census Reports, *Twelfth Census* (1900), Vol. VII, pp. ccxiii ff., for one of the best discussions of the causes for the localization of industry, as well as for further examples of localized industry.

[13] See pp. 91–93.

tables from the surrounding growers. There is also a large volume of local slaughtering of meat animals, and butter and cheese are commonly made in local creameries and cheese factories. Even in such cases, however, products must be collected from a large number of individual growers in order to secure a sufficient supply.

Dispersion.—It appears, then, that products of the farm used as the raw materials of manufacture, as well as those consumed in their original state, must often be brought together from wide areas. Then, the consumption goods and the manufactured articles into which the raw materials have been converted must be dispersed to consuming areas. These consuming areas are sometimes fully as distant from the manufacturing plant or central market as the producing areas, and often more widely separated.

II

Bearing in mind the foregoing characteristics of farm products—the need for concentration preceding final distribution, the peculiar characteristics of farm products, the rather low efficiency of the average farmer as a trader, and the frequent absence of demand creation as a determining factor in exchange—the actual methods of marketing farm products will next be considered.

There is no one method of marketing farm products. Even a single producer or buyer may utilize several methods of selling or purchasing.[14] There are, nevertheless, certain gen-

[14] "Of the 138 vegetable growers in the United States who answered the author's query as to whether they sold to local purchasers, cash-buying jobbers, retailers, or consumers, 39 answered that they sold to wholesalers on consignment, 30 to cash-buying jobbers, 31 to local purchasers, 51 to retailers, and 22 to consumers. That is, one-half of these growers sold either to retailers or consumers. Nor are these growers limiting themselves to any one of these five outlets for their goods. Thus, of the 138 who responded, 17 sold to all five, that is, to wholesalers on consignment, cash-buying jobbers, local purchasers, the retailer

eral types of distribution, into one or a combination of which most methods can be placed.

Methods Open to the Farmer: (A) Direct Sale to Consumer or Manufacturer.—The methods by which individual farmers market their products are numerous. The simplest is by direct sale to consumer or manufacturer. There are three familiar types of direct sale: (1) sale at the residence or plant of the purchaser, or at the farm of the seller, (2) on the public market, and (3) through the medium of the parcel post or express companies when these act as agents of assembly and transportation.

The huckster.—The familiar huckster selling his products from door to door is an important example of direct sale to the consumer. But not all hucksters are producers. Many purchase all or a part of their produce from auction companies, commission men, and other dealers, as well as directly from farmers. Huckster sales are usually for cash and delivery is made at once. When carried on by the grower himself, huckstering takes much time from the work of production, as sales are made in small quantities and relatively slowly. Consequently, this method is not likely to be used by growers pressed for time, unless they are selling a clientele willing to pay enough, because of the special nature of the product, to offset the time lost to production.

A closely related type of direct sale is found in the case of the farmer or his wife who has a few customers in the neighboring town to whom produce is delivered at intervals. Poultry, eggs, and butter are frequently sold in this way.

and the consumer. Seven more sold to wholesalers, cash-buying jobbers, local purchasers and retailers. Others sold to three or more of these.

"Nor are the growers alone the only class of business men who are organizing their purchasing and selling methods. The wholesaler is turning jobber. He is sending his automobile direct to the farm and is selling direct to the retailer. The jobber is buying direct from the farm and is selling direct to the retailer."—Clyde L. King, *American Economic Review, Supplement*, Vol. V, No. 1 (Mar., 1915), p. 155.

Direct sales to manufacturers.—Sales of raw materials by growers to manufacturers are made in a number of ways with different crops, and even for the same crop. They are often made in advance of the harvest, sometimes long before, and the selling price is frequently stipulated in advance. This assures the farmer a definite price when the harvest is over. But though he is insured against a very low return, it is the general impression that over a period of years the returns average lower than the average of the market for the same period. This is not necessarily a criticism of the manufacturer. It is evident that one who sells a finished product on a competitive market must protect himself from guaranteeing what may prove to be much more than the market price for his materials. Otherwise, if the cost of his raw materials proves to be far above the prevailing market he will find that competitors who buy at the market price can far underbid him in the sale of his product.

A common method of direct sale to manufacturers is found in the case of farmers who haul their product to local mills or factories and there dispose of them at the prevailing market price. This is common in the sale of wheat, corn, and other cereals, and of fruit and vegetables sold to canning factories. Sales to distant manufacturers are often made through representatives of the manufacturers who come directly to the farm, or station themselves in the town to which the grower hauls his product. Thus some cotton is sold by large planters to mill buyers who go about from place to place seeking the special kind of cotton their mill uses, and some flour mills have established their own elevators in regions where the quality of grain they use is grown. Wool and tobacco, likewise, are sometimes sold in this way. In other cases, large growers themselves approach the manufacturer and attend to the sale as well as to the shipment of their product.

Public markets; parcel post and express sales.—Public market places are provided sometimes by private initiative

and sometimes at public expense. They afford an opportunity for direct selling of some importance. But by no means all who sell on the public market are growers; in fact retail dealers often predominate. Public markets, although relatively unimportant, have awakened much interest during the recent period of high prices, and appear to be growing in importance.

Sales delivered through the parcel post and the express company are difficult to classify, for other agencies are concerned to so large an extent that it is hard to decide whether they should be classed as direct or indirect. Even in making the sale other agencies intervene. Thus in some states a state market agency endeavors to bring producer and consumer together through the use of printed bulletins; the express companies and the post office department also assist in making the actual sale through bringing consumer demands and producer supplies together.

Direct sale of fruits, vegetables, and dairy products.—The direct sale of fruits, vegetables, and dairy products to ultimate consumers seems to be less prevalent than the direct sale of raw materials to mills and factories. The reasons are not far to seek. A grower can haul a load of wheat to the local mill, sell and unload it, and return in a relatively short time; but if he tries to sell a load of apples to final consumers, he must peddle in small lots from house to house, and so put in a considerable part of his day in marketing. Most farmers are unwilling or unable to spend so much time in this way; they prefer to sell quickly in large lots to middlemen, such as the jobber, local shipper, or retailer; and then to return to the work of the farm.

Again, fruits, vegetables, and dairy products are often grown far from the ultimate market. The great consuming areas of California fruits, Colorado cantaloupes, and Latin American bananas, are in populous districts far removed from the producing areas. The fresh vegetables consumed in our larger cities are grown in a wide area surrounding the city and in growing

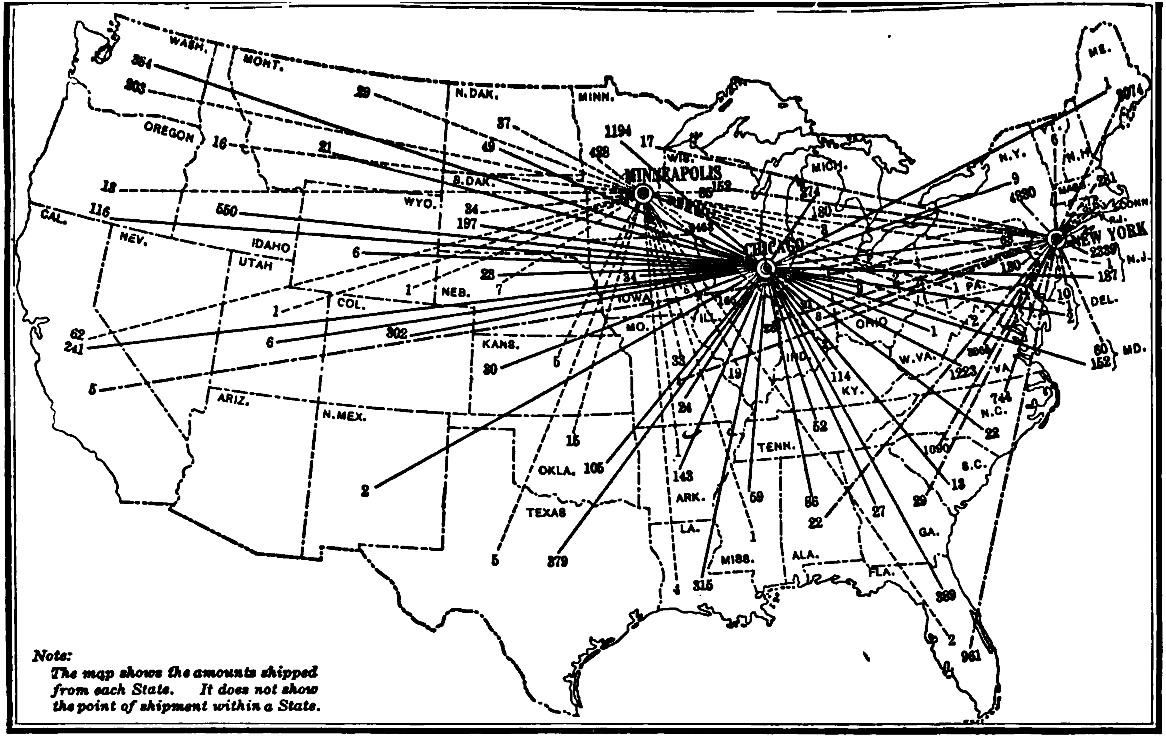
regions not geographically tributary. It is physically impossible for the average grower to haul his products to such markets and practically impossible for him to establish satisfactory business connections for their sale there. So not only must his goods be shipped by some general transportation agency, but he is likely to find it easier to turn the whole operation, including the sale, over to a marketing specialist.[15] Furthermore, a product which is consumed out of season, either directly or by mills and factories, can often best be stored by independent agencies who have the proper facilities, together with the requisite financial resources, and who are in close and constant touch with the market.

Methods Open to the Farmer: (B) Local Middlemen.—Although farm products in large volume are handled through direct sales by the grower to manufacturers and final consumers, the greatest volume of business is carried on through one or more independent intermediaries. There are five important classes of these intermediaries who buy in the local market: (1) the retail store; (2) the buyer who travels about from farm to farm either on his own account or as the representative of a mill, factory, or central market middleman; (3) the local buyer with a definite place of business to which growers bring their products for sale; (4) the producers' coöperative selling association; and (5) the middleman located in an outside market.[16]

The second and third methods are sometimes engaged in by

[15] The development of better roads and the use of the motor truck will bring a much wider area into contact with a given consumer market, but this will modify this statement only as it relates to products grown in the general vicinity. Even here the motor transportation may be taken over, as it is now in many instances, by functionalized agencies.

[16] Another local market middleman should be mentioned, who while handling but little of the total volume of the country's agricultural products further illustrates the possibilities of specialization. He is the general consignee, or forwarder, who "stands between the individual shipper in the country and the commission man in the large cities



MAP. I.—The Concentration of White Potatoes, 1917. Car-lot Shipments Unloaded at New York, Chicago, and Minneapolis.[1]

[1] This map is copied by permission from the *Report of the Federal Trade Commission on the Wholesale Marketing of Food*, facing p. 46. It was drawn from data furnished by the Bureau of Markets.

the same individual. The methods, however, are unlike, as they involve a somewhat different distribution of functions. Furthermore, the middleman with a definite place of business to which the growers bring their products is usually an evidence of an advanced stage in marketing.

(1) Sales to retail stores.—Great quantities of fruit, vegetables, butter, and eggs are sold directly from the farm to retailers. Some growers have a regular clientele of retail dealers to whom they sell. It is more convenient for the farmer to sell to retail stores than it is to huckster his product, for although he may receive less money for it, less time is consumed and less trouble is involved. Local hotels, restaurants, and delicatessens offer a similar attraction to the grower. To the retailer the main advantage of this scheme is that it assures him a supply of fresh fruits and vegetables in season. But there are important difficulties attending it. He may have to buy from several growers to have a sufficient quantity and variety of products for his trade. This increases the time and effort he must devote to buying. He must usually pay cash to the grower, whereas he can get credit from the jobber. Again, the source of supply is far from dependable; on any day one or more of his growers may fail to deliver, the quality and quantity of local crops vary widely from year to year, and in order to keep a steady supply throughout the season the retailer must deal with a large number of growers located in widely separated parts of the country. Many retailers meet this last difficulty through buying from local growers during their local season and purchasing out of season supplies through wholesale dealers.

(especially Chicago). His principal reason for existence is that he consolidates the small shipments of individual growers into car lots thus obtaining for the shippers the benefit of lower freight rates." He deals mainly with perishable products and makes his profit from selling space in cars at more than the carload rate, yet lower than the less-than-carload or express rates. See L. D. H. Weld, *The Marketing of Farm Products* (1915), pp. 105-107, and see J. H. Collins, *The Country Gentleman,* Mar. 13, 1915.

The country general store.—The country general store is of great importance to growers in some sections of the country. These stores buy food stuffs for local sale at retail and raw materials for shipment to outside markets. This method of purchase is, as a rule, a sign of an undeveloped marketing system, or of a small local production of the crops marketed through the general store. It is usually succeeded by another type of local agency as soon as conditions become settled and production increases.

The general store merchant purchases from his producer-customers their butter, eggs, fruit, cotton, or other products. Of these he retains those which he can best sell to his local trade and ships the surplus to dealers and manufacturers in the central market. He often pays for the goods "in trade," i. e., he exchanges goods for goods. The fact that the general store both buys from and sells to the farmer frequently renders this method unsatisfactory to both parties to the exchange. When this is done either the retail trade or the shipping trade of the storekeeper is usually more profitable than the other, and he is likely to allow the less important to suffer in order that he may keep the good will of the more important trade. Butter is frequently bought by general stores at a flat rate regardless of quality, and eggs by the dozen, also with no regard to quality. Apparently the dealer either does not care to take the trouble to grade his purchases, does not know how, or, more than likely, he fears to lose the good will of his customers if he pays more to one than to another.[17] Eggs and butter are often held until there is a suitable quantity for shipment, with unfortunate results to their quality. Grain, hides, wool, cotton, and a few other crops are bought to some extent by general stores, and although these do not deteriorate so rapidly as do butter and eggs the evils of poor grading and inadequate storage are present. Poor grading penalizes those

[17] Of course, some local stores do roughly grade the product which they buy and pay according to grade. This practice is becoming more general in recent years.

who endeavor to produce a good product and tends, consequently, to discourage the improvement of production, to the detriment of all concerned. Poor grading also makes further inspection and grading necessary at a later point. The wastes from inefficient storage are often great.

What has been said is not necessarily in disparagement of the work of the general merchant.[18] A needed service is performed in this way at those markets where the volume of business is too small to warrant the presence of a specialized country shipper. But as a community becomes established and its production specialized, specialized traders appear and take over the buying activities of the general store. This may be brought about by the general merchant's giving up his retail business and specializing in handling certain farm products, or by his making this part of his business distinct from his retail trade; or it may come about through the appearance of independent buyers in the local market.

(2) Traveling buyer.—In the sale of fruits and vegetables, poultry, butter, eggs, hops, wool, cotton, rice, and cattle, it is common for growers to sell to traveling buyers who go about from farm to farm or who station themselves at a local shipping point to meet the growers as they bring their produce to town. Some of these buyers are independent dealers; others are the representatives of central market dealers or of manufacturers. In some fruit and vegetable districts buyers go about in their wagons buying fruit, vegetables, butter, poultry, and eggs, which they carry to the city retailers and jobbers. Cotton is sold to buyers representing export houses, brokers, and mills, who purchase directly from the growers at local markets, warehouses, steamboat landings, and railroad stations, as well as at the farm and plantation. Where the raising of live stock is a secondary industry local buyers sometimes go from farm to farm purchasing stock from individual growers and combining these in carload lots for shipment to central markets.

[18] For a further discussion of the country general store see pp. 186–187.

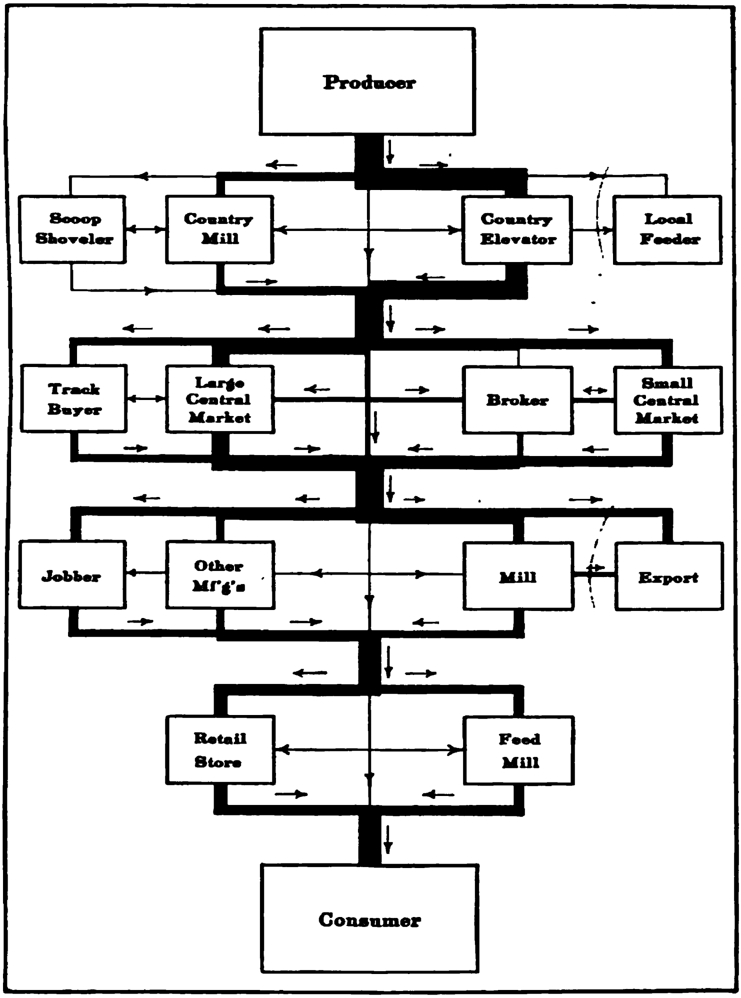


DIAGRAM III.—Marketing Grain at Country Points.

The purpose of this diagram is to list the important agencies handling grain and grain products and, in so far as it is possible by means of a diagram, to show their natural relationship to each other and to the producer and consumer. The width of the line leading to and from each agency indicates in a general way the comparative volume of trade passing through this channel, the arrow indicating the direction of the movement. Commercial intercourse between coördinating agencies is indicated by cross lines. In some instances transactions may take

(3) Local buyer.—The local grain elevator is the most common example of the specialized local buyer with an established place of business to which the growers haul their product for sale. The owner of the elevator usually purchases grain from the farmers in bulk, grades it roughly as a basis for payment, holds it in his elevator until his judgment dictates shipment to the central market, and ships in carload lots.[19] Sometimes, especially with grain of low grade or at times when the market is disorganized, business is done on a commission basis.

"At the present time the primary functions of country elevators are two in number, and in the order of importance they are, first, the merchandising of grain, and, second, the warehousing of grain. Minor functions are, the elevating of grain for farmers and others, the cleaning and conditioning of grain either for the elevator's own account or for others, the handling of side lines, etc. . . .

"In performing its various functions, the elevator becomes a very important factor in the marketing of grain. Most of the grain marketed at country points is bought by the elevators directly from the farmers for the purpose of resale. If, however, the farmer does not care to sell his grain immediately after harvest, he may store it in the elevator,* for which service a fee is usually charged. In some cases the farmer may decide that he will ship his grain himself. In such a case the elevator perhaps elevates the grain and loads it into the car. Or, again, if the grain received by an elevator either for its own account or for that of farmers, contains an admixture of foreign matter the elevator, if

[19] During years when there is a shortage of cars this is a very risky undertaking. See, however, the discussion of hedging on pp. 362–372.

* "Some elevators however refuse to accept grain for storage."—

place between agencies in the reverse order in which they are listed, thus bringing about what appears from the diagram to be a backward movement. Such transactions, however, are infrequent and do not influence the general direction of the movement to any great extent. The diagram is not intended to show any precise or sharply defined routes traveled by grain in passing through the channels of trade from producer to consumer, nor is it intended to show the relative merit or value of the service contributed by the several agencies to the present system of grain marketing.†

† G. K. Livingston and K. B. Seeds, *Marketing Grain at Country Points,* U. S. Department of Agriculture, Bul. No. 558 (1917), p. 13.

it is equipped to do so, may clean the grain thus improving its merchantability.

"In addition to handling grain, either as a merchandiser or warehouseman, many country elevators, and to a lesser extent warehouses, deal in various other commodities. These commodities, especially coal, feed and flour, seed, and lumber, are sold in large quantities to farmers, and numerous elevators also buy and sell wool, beans, poultry, eggs, potatoes, etc. So far as the elevator or warehouse is engaged in these operations, it acts as an ordinary merchandiser, and such operations have no direct relation to the functions of the elevator in connection with the grain business." *

These local elevators are sometimes owned and operated by a local business man, in which case they are known as "independents." They are sometimes units in a "line" elevator system composed of a number of local units, controlled from headquarters in a central market, and usually owned by large grain dealers. A few are the property of millers, and others are owned coöperatively by growers themselves.

In large towns there are local buyers who purchase butter, eggs, and poultry from farmers and general merchants in nearby towns for further shipment to central markets. Throughout the northern potato region growers sell to local warehousemen who buy and store the potatoes on their own account and often sort and grade them. They will also store for the grower and sell for him on commission. Fruit packers buy from growers in California, and wool is sometimes sold to local buyers.

As these local dealers usually pay the grower cash for his product, they need rather large supplies of capital during the season when shipments are heavy. Furthermore, the products are frequently consigned by the dealer to central market commission men or sold subject to grading at the central market. Consequently, but for the financial arrangements made with his customers in the central market and with the local banks,

* *Report of the Federal Trade Commission on the Grain Trade,* Vol. I, *Country Grain Marketing* (Sept. 15, 1920), pp. 23–24.

the local buyer would need to possess a large amount of capital. But it has become common practice for the local buyer to draw drafts on the central market dealer for a large percentage of each shipment, the balance being sent on after the sale is complete. This shifts a large part of the burden of financing purchases at local markets from the local shipper to middlemen in the central markets.

(4) Coöperative shipping.—Coöperative shipping by associations of growers is becoming an important outlet for the products of many sections of the country. Grain, fruit, vegetables, dairy products, live stock, and other products in large volume are shipped through these associations. These will be discussed in Chapter XIII.

(5) Sales to middlemen in outside markets.—Sales made directly to middlemen in outside markets, as well as to distant manufacturers, are usually feasible only in the case of large producers. For in order to utilize this method to the greatest advantage the grower must be able to ship in carload quantities; otherwise the freight cost will usually be prohibitive. The trouble involved in establishing business contacts with distant buyers, the fear of unfair treatment, and the usual necessity of awaiting returns until the arrival of the product at the central market—all of these are further disadvantages of direct shipment to central markets. Live stock is frequently shipped by large growers to commission men at the stockyards, and direct shipment by growers to commission men is common in the sale of fruits and vegetables. Live poultry is sometimes shipped to commission men of the produce market and milk to city distributors and to large butter manufacturers—in each case by fast freight or express. A large volume of cotton is consigned to factors for sale on commission and some is sold directly to mills.

CHAPTER IV

THE WHOLESALING OF FARM PRODUCTS

Agricultural wholesaling is the term applied to the process of concentration followed by dispersion and assembly which is characteristic of agricultural distribution.[1] On the one hand, it reaches out to the grower, establishes business connections with the farmer and the country shipper, and concentrates products at the central market; on the other hand, it reaches out to the mill, the factory, and the retail store.[2]

Establishing Business Connections.—To take the product of the farm and transfer title to its ownership to buyers in the central market involves the establishment of business connections between the dealers of the central market and the growers or local shippers in the country. This may be accomplished through personal solicitation, correspondence, advertising, telegraph, and telephone; and the impetus to exchange may come from either the seller or the buyer. In the fruit district of Delaware, for example, representatives of the dealers in the Philadelphia wholesale market buy fruit from the growers' wagons at local shipping points; in the Middle West bids for grain are sent to local buyers from day to day by mail, telegraph, and telephone. Again, on the other hand, growers and local shippers may consign their goods to central market dealers, or seek buyers in the central markets.

Facilities of the Wholesale Markets.—In order that advantage may be taken of carload rates and car storage privi-

[1] See pp. 2–3, 19, and 39–42.

[2] It is this process which has been the subject of so much indiscriminate attack in the propaganda against "middlemen." The general subject of the elimination of middlemen will be discussed in Chap. XIV.

leges, farm crops are usually shipped to central markets in carload lots. Often a large part of the year's crop is sent in during a comparatively short period of time. In consequence, facilities must be provided for handling car lots and for storing the crop until it is wanted. This involves storage, insurance against loss from such casualties as fire and storm, and, through hedging, against loss from price changes. Facilities must also be provided for assorting produce into the styles and grades demanded by the trade,[3] for the division of the large lots in which the products are held into suitable quantities for further distribution, and for packing commodities for further shipment. Furthermore, there is need for a market news service, as well as for financial and credit facilities. These demands of the market have brought into being a multitude of specialists who are directly or indirectly connected with the wholesale market.

"These central markets are equipped with large terminal elevators and warehouses, exchanges, auction rooms, livestock yards, rail and water transportation facilities, inspection rooms, banking facilities, and all equipment needed for the storage, preparation, handling, purchase and sale, insurance, shipment and financing of large quantities of farm products. Commission men, brokers, auctioneers, wholesale dealers or jobbers, central distributors, contractors, exporters, importers, speculators, elevator and warehousemen, bankers, insurance men, ship brokers, inspectors, weighers, freight forwarders, trucking agencies and other commercial interests are engaged in the wholesale trade which is conducted in these markets. Many of them are, furthermore, equipped with numerous retail establishments and with flour mills, cotton or woolen mills, malt houses, meat packing plants, tobacco factories, or other consumers of farm products who depend upon the central wholesale markets as a direct source of supply."[4]

Distribution from Central Markets.—There are a number of channels for the distribution of products from central mar-

[3] This must be done if it has not been well done at the farm or in the country market, and it very often has not.

[4] Grover G. Huebner, *Agricultural Commerce,* p. 14.

kets. A very large percentage is sold locally to mills and factories for processing—as in the case of live stock, grain, cotton—and many food products ready for sale to consumers are sold to local retail stores; but another large part is shipped out to other central wholesale markets, to jobbing markets, and to outside retail markets.[5]

Products are often shipped from one wholesale market to another. This is sometimes necessary because—as the result of an inefficient market news service—too much of a product is sent to one market and too little to another. In consequence the price in the latter becomes high enough to warrant reshipment. Thus fruit that was shipped to a wholesale market in which an oversupply had caused a fall in price has been known to be shipped out to another market. But when the fruit reached the second market the price had fallen there and it was shipped back to the first, where it was finally sold at retail.[6] This procedure is wasteful, but it is becom-

[5] The table below—from the *Report of the Federal Trade Commission on the Grain Trade* (1920), Vol. II, p. 24—shows the average annual receipts, shipments, and local consumption of wheat from 1913 to 1917 in 10 primary wheat markets of the United States.

TABLE IV.—*Average annual receipts, shipments, and local consumption of wheat at 10 primary markets for the five calendar years 1913 to 1917.*
[In bushels, 000's omitted.]

	Receipts.	Shipments.	Local consumption.	Per cent of local consumption to receipts.
Minneapolis	120,151	38,521	81,630	67.94
Kansas City	55,612	43,986	11,626	20.91
Chicago	65,412	58,127	7,285	11.14
St. Louis	34,209	27,090	7,119	20.81
Omaha	21,275	17,889	3,386	15.92
Milwaukee	8,062	4,933	3,129	38.81
Duluth	56,884	54,090	2,794	4.91
Indianapolis [a]	3,390	1,255	2,135	62.98
Cincinnati	5,955	4,356	1,599	26.85
Peoria	3,079	2,974	105	3.41
Total	374,029	253,221	120,808	32.30

[a] 2-year average, 1916–17.

[6] J. Russell Smith, "Price Control through Industrial Organization," *Annals of the American Academy,* Vol. LXXIV (Nov., 1917), pp. 280–283.

ing less and less common as facilities for gathering and disseminating market news improve. In a greater number of cases products are sold by dealers in one central market to those in another, because, as in the last case, the demand at the second is relatively greater than at the first. But, as the second market has no established business connections with growers and local shippers who are normally shipping to the first, it is found easier and probably cheaper to buy from the dealers of that market. The product itself may in fact go directly to the second market and only the purchase be made through the dealers of the first. Cotton, for example, is very largely bought by eastern mills through New York dealers, but much of the actual cotton is stored by the dealer in southern cities, or by local merchants in the South, from whom the New York merchant purchases. The cotton itself may never reach New York.[7]

Goods ready for personal consumption without processing are shipped in large amounts from central markets to jobbing markets in the same, as well as in other, cities. Fruit, for instance, comes into the wholesale market at West Philadelphia in carloads. There it is divided into a few large lots and sold to retailers and jobbers. Some of the fruit sold to jobbers is taken by them to the jobbing market on Dock Street in Philadelphia, where it is sold in smaller quantities to retailers. It is also sold to those jobbers from outside the city whose sales in their own cities are not large enough to warrant buying at the West Philadelphia market.

Classes of Markets.—Several types of markets may be distinguished in the domestic marketing of farm products. Among the more important of these are: (1) local markets, (2) central or terminal markets, (3) secondary wholesale markets, and (4) retail markets. Local markets are those markets—close to the areas of production—in which the farmer can dispose of his products to final consumers, mills,

[7] See M. T. Copeland, *The Cotton Manufacturing Industry of the United States*, pp. 179–184.

factories, or local shippers. They are also called growers' local markets and country shipping points. Central or terminal markets are markets in which products are concentrated from the growing areas and from which they are shipped on to other wholesale markets, or dispersed to mills or factories, and to jobbing or retail markets. Secondary wholesale markets may be central wholesale markets which receive goods from central markets to disperse to mills and factories, and to jobbers; or they may be jobbing markets. In the latter case they are also called jobbing markets, or consumption wholesale markets.[8] In the retail market are found the public retail market places, stores, hucksters, and peddlers that supply the final consumer. Most markets combine from two to four of the types of trade on which this classification is based, and so it is not always easy clearly to differentiate a particular market. There is, however, usually one class of trade which predominates.

Relation of These Markets to Consumption Goods and Raw Materials.—Products ready for personal consumption without processing are likely to be sold through agencies operating in each of the first four markets. They are also likely to be physically handled in each before their final consumption. Raw materials for manufacture, on the other hand, usually pass through but two: the growers' local market and the central wholesale market. In case they are manufactured into consumers' goods they may then go through the jobbing and retail markets for manufactured goods.

Fruits serve for illustration of products used for final consumption in their original state. These are commonly concentrated at local shipping points and then dispatched in car-

[8] For extended discussions of markets in the wholesale produce trade see E. G. Nourse, *Chicago Produce Market; The Report of the Federal Trade Commission on the Wholesale Marketing of Food* (June 30, 1919); L. D. H. Weld, *The Marketing of Farm Products*, Chaps. II-IV, VII, VIII, XVIII, XX; and G. G. Huebner, *Agricultural Commerce*, Chap. II.

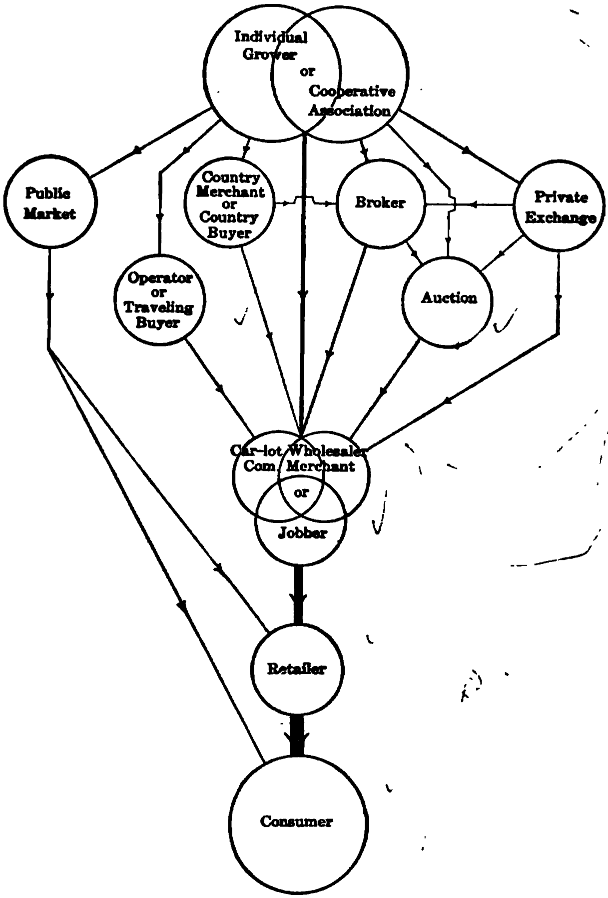


DIAGRAM IV.—Main Channels of Distribution for Fruits and Vegetables.*

* J. H. Collins, J. W. Fisher, Jr., and Wells A. Sherman, *Methods of Wholesale Distribution of Fruits and Vegetables on Large Markets*, p. 22. U. S. Dept. of Agr., Bul. 267 (1915).

load lots to central markets. Here they are sold to local distributors, to dealers in outlying markets in the same city, and to jobbers in smaller cities. These latter dealers are mainly the middlemen of the jobbing market whose function it is to link the large receivers of the central market with the retail outlets for fruit. They buy in large lots from the wholesale receivers of the central market,[9] and divide these large lots into smaller quantities of the proper grade and quality, to be sold to the numerous retail outlets which supply the consumer.

Grain serves as a good example of a raw material. The bulk of the grain from the wheat belt is sold to elevator companies at local markets, and shipped to a central market, such as Minneapolis, Chicago, or Duluth, where it is held by central market dealers and either stored or used in local mills. Of the stored grain, as well as of incoming grain just received at such markets, a goodly portion is sold to dealers and mills in other regions, domestic and foreign.[10] Grain does not enter into jobbing market transactions, and it is not ready for final consumption, but it may actually change hands several times before reaching the mill in which it is to be used;[11]

[9] See pp. 86–87.

[10] "There are a number of different routes over which grain from these primary markets is carried to seaports or to eastern mills." These include the lake routes from Duluth and Chicago, and all-rail shipments and the rail-and-canal movement, through Buffalo to the seaboard. "Lake-and-rail routes terminate also at other north Atlantic ports besides New York, the transfer from lake to rail being made at eastern ports of Lake Erie, and even as far east as Ogdensburg, on the St. Lawrence River.

"In addition to the shipments eastward and across the Canadian border, an important outlet for the grain grown in the Great Lakes region, especially in the southern part of it, has been opened toward the south, and a large part of the traffic is thus diverted through the Gulf ports."—From George K. Holmes, *Systems of Marketing Farm Products and Demand for Such Products at Trade Centers* (1913), U. S. Department of Agriculture, Report No. 98, pp. 68–69.

[11] Much of the changing of hands which takes place is but the change

and it may pass from primary wholesale markets to other domestic wholesale markets, or to seaboard and foreign wholesale markets.

Functions of These Markets.—Although the functions performed by the different markets are in some regards similar, there are special reasons for the existence of each. The principal function performed in the local growers' market is to make it convenient for the grower to sell his produce and to facilitate the collection of the products from growers in sufficient quantities to send them to large markets in carload shipments. This, the first step in the concentration of agricultural products at the great central markets, usually calls for provision for weighing, storing, loading, and in some cases, as with fruits, for assorting, grading, and packing. It provides the farmer with a ready market in case he desires to sell or ship at once, or with storage facilities when he prefers to hold his product. In case his production is small, he is saved the extra expense of shipping his own product in less than carload lots, as well as the difficulties involved in establishing direct business contacts with the central market. Throughout the great grain, live stock, cotton, tobacco, vegetable, and fruit growing regions there are hundreds of such markets in which one or more middlemen are found ready to deal with the growers.[12] To provide facilities for shipping commodities out of the community is not, however, the only function of the local merchant, for many of the purchases made there are for local consumption or for use in local plants.

Central Markets.—It has been shown that most agricultural products, whether sold to mills and factories or consumed

of ownership. The grain is likely to remain stored in one place until the miller wants it for use.

[12] 13,916 local grain elevators and warehouses were reported to the Federal Trade Commission as being in existence in the principal grain states in 1919. *Report of the Federal Trade Commission on the Grain Trade*, Vol. I, pp. 33–35.

in their original form, must be collected from wide areas and concentrated at the great centers of manufacture and consumption, and that even products sold to smaller cities and to farmers themselves must often be concentrated before they are dispersed to these smaller markets.[13] Central markets, located at the center of that process of concentration followed by dispersion which has been described, are important factors in this process. They are found in cities located strategically between the great producing and consuming areas and possessing superior transportation facilities.[14] Cities of this kind are themselves commonly large manufacturing and consuming centers in which great quantities of the products concentrated therein are used.[15] To handle the products manufactured and consumed locally, as well as those which center there to be shipped to dealers, manufacturers, and consumers at other points, an efficient market mechanism has been developed; and this has been expanded to handle far more than local consumption demands. Here are found the great storehouses, banking and credit agencies, exchanges, and other market institutions so important to successful distribution. Because of their equipment and because of their strategic location and the large volume of products used there, it is but natural that producers turn to such cities for a market in which to sell, and that buyers look to them as a source of supply.

[13] There are sometimes preliminary points of concentration to which goods are shipped before they are sent to the great terminal markets. Thus in the produce trade, poultry and eggs are quite extensively collected at these local markets and from there sent on to the larger markets. Tobacco is often handled in a similar manner and cotton is collected at local points of concentration from which it is sent on to larger markets.

[14] See Ellen Churchill Semple, *American History and Its Geographic Conditions* (1903), Chaps. XVI and XVII.

[15] There are important exceptions: New Orleans consumes little cotton; San Francisco, no wool; Galveston and Port Arthur consume little wheat. These last two are really export markets, or transshipment points, rather than true central markets.

Chicago, St. Louis, Kansas City, and Minneapolis, the centers of large consuming areas, strategically located between the centers of production of grain, live stock, and other farm produce and the centers of manufacture and consumption, are important central markets. Each is at the head of water navigation for a large producing area,[16] and each is at the center of transportation systems which connect great agricultural districts with populous districts to the south and east.[17] Galveston and Port Arthur are somewhat similarly located with respect to the grain which goes to market by way of the Gulf, but these cities are not great markets, in part because they do not have an important consuming and manufacturing population. They are transshipment points between railroads and vessels. New Orleans and Baltimore, in similar locations, and having in addition—particularly in the case of Baltimore—a large consumption demand, are great central markets, as well as transshipment points for cotton and to-

[16] This is not literally true of Minneapolis today, of course, because the river is seldom used at present. But the railways now supply the needed transportation.

[17] "For the South—with its autumn turkeys, winter vegetables and citrus fruits, early spring eggs, and early summer peaches and melons—Chicago stands as the natural gateway to many other cities and towns of the North, as well as the home of three million ultimate consumers of these products. Not less is it the gateway *to* the South, through which a great volume of the products of the North are distributed—late fruits and vegetables to prolong the Southern 'season,' and, during the winter, hardy fruits and vegetables, apples, and cranberries. From the mid-West (besides live stock, and cereals), dairy products, eggs, and poultry are drawn to Chicago's *depôt*, and the surplus over her own needs sent East to other consuming centers or to points of export. From producing and importing points in the East she draws supplies—bananas, lemons, grapes, cheese, cabbage, and other fruits and vegetables—for her own use and for re-sale to other markets farther west. In turn she helps to supply the Eastern markets with every choice product of the Western country—Minnesota butter, Iowa eggs, Colorado cantaloupes, California fruits and winter vegetables, Northwest apples, and countless other products."—Edwin G. Nourse, *The Chicago Produce Market*, pp. 7–8.

bacco respectively. The Pacific ports serve as central markets for the produce of the far West.

Dispersion from Central Markets.—Of the goods concentrated at central markets, many are sold there—the raw materials to local manufacturers, the consumers' goods to the people of the community. But concentration takes place far in excess of local consumption and production uses, and products are shipped on to other consuming and manufacturing centers.

This tendency to concentrate wholesaling at a particular point grows with time until it may well be true that, although much of the produce could pass as efficiently through other cities, it continues in the usual way by reason of the customs and habits of the trade and the lack of trade facilities in other cities. And even when such changes do take place the general tendency toward concentration is not eliminated; it is merely transferred in part to another center. As the live stock industry, for example, moved westward, first Cincinnati and then Chicago became the chief center. The latter is still the principal center, but St. Louis, Kansas City, Omaha, St. Joseph, St. Paul and other cities have gradually become central markets for live stock, in part to supply local packing houses, in part as primary markets in the concentration of live stock to supply numerous packing plants farther east.

It is possible to carry on the process of transferring title through the large market without actually shipping the product there, and many products bought and sold on these markets never actually reach them. In the latter case the advantages to be derived from having all purchases and sales for a large area concentrated at one point can be gained, without the disadvantages which may arise from physically concentrating the goods there. New York cotton merchants, for example, sell to New England mills cotton stored in southern cities and have it shipped directly to the mills; and Chicago brokers and merchants divert to other markets products en

route to that city, or ship to eastern markets goods stored at points outside Chicago. In such cases only the transfer of title takes place through the central market, with perhaps some financing or hedging transactions supplementing the exchange.[18] The proportion of the concentrated crops which is consumed locally, as contrasted with that which is shipped to nearby markets and to distant markets at home and abroad, varies greatly.[19] Many of these markets, in addition to obtaining goods directly from growing areas, also receive large amounts of their products from other central markets, domestic and foreign.

Primary Markets.—In the grain trade the central markets which receive products chiefly from the growers' markets are commonly called primary markets. These markets are found at strategic locations in the grain growing states and are generally on the Great Lakes or inland waterways. They are well equipped with railway facilities both for receiving grain from the country and for shipping it eastward and southward to other parts of the country, in which it is used domestically or from which it is shipped abroad.[20] Practically all of these

[18] Financing is discussed in Chap. XVI, hedging in Chap. XVII.

[19] "Over 180,000 cars of perishable foods are consigned annually to Chicago, but nearly half of these are transferred and reconsigned to other points, especially to the eastern markets. The expense and waste incident to delays and difficulties of switching cars from the line on which they arrive to the line of departure from Chicago, and the value of the time lost in locating and inspecting cars at the various yards, constitute an important item in reconsigning cars from Chicago, and is passed on to the ultimate markets as fully as is possible."—*Report of the Federal Trade Commission on the Wholesale Marketing of Food* (1920), p. 116.

[20] Some of the more important primary markets are Chicago, Minneapolis, Kansas City, St. Louis, Duluth, Milwaukee, Omaha, Peoria, Louisville, Cincinnati, Indianapolis, Toledo, Cleveland, Detroit, Wichita. Water transportation is now important to less than half of these points. But their strategic location on waterways accounts in large part for their original development as markets.

markets are situated in cities where local mills, distilleries, and other manufacturing plants consume large quantities of the grain received. As a rule, however, these markets reship well over half their receipts.

Seaboard Markets.—There are also large seaboard markets on the Atlantic, Pacific, and Gulf coasts.[21] The grain received at eastern markets is principally distributed throughout the East, but it is also exported, and much of the grain exported from interior markets is shipped through these ports. The Gulf ports—New Orleans, Mobile, Galveston, Port Arthur—serve very largely as exporting markets, although much of the grain passing through them is actually sold through other markets. The Pacific ports—San Francisco and Portland, and the Puget Sound ports—in addition to performing these functions, are also primary markets for the western grain and wool growing areas. They also serve as local markets, since much western grain is shipped directly to these cities without being sold at growers' markets.

The Cotton and Wool Markets.—Export markets are more important in the marketing of cotton than of grain because more than half the cotton crop is usually exported, chiefly to England, Germany, and France, whereas until the World War the increasing domestic demand for grain had made the foreign markets less and less important. Although a large part of the cotton crop is concentrated at interior central markets—"interior points of concentration"—such as Dallas, St. Louis, Memphis, Augusta, and Montgomery, over half the crop is usually shipped directly from local shipping and compress points to local mills, eastern mills, seaports, and directly to foreign markets. More than two-thirds of the crop is annually shipped to the southern ports from local markets. It is there consumed locally, sold on local markets, or transported by water to northern cities and abroad. New York

[21] Boston, New York, Philadelphia, Baltimore, Newport News, New Orleans, Galveston, San Francisco, Seattle, etc.

and Boston receive most of their cotton from the central markets of the interior and from the southern ports, rather than from local shipping points.

Most of our great American crops, the cereals, cotton, tobacco, are important export crops. Wool on the other hand is more largely imported than exported, over one-third of the local consumption being foreign grown. Here likewise there are interior and seaboard central markets. But the seaboard markets, of which the chief are Boston, New York, and Philadelphia, are of far greater importance than the interior markets, because they serve as import markets, are in the center of the wool manufacturing areas, and are favored by rail rates for the handling of the domestic clip. Chicago, St. Louis, and Omaha are important interior markets; and San Francisco and Portland, well located for ocean shipment and with favorable transcontinental rail rates, are also important.

Exchanges and Auction Companies.—A distinguishing feature of central markets is the importance therein of the sale of farm products upon exchanges. There are two types of exchanges: those on which a single product is sold, and those on which several products are exchanged.[22] The Chicago Board of Trade and the New York and Boston produce exchanges are examples of the latter. But wool, cotton, tobacco, and dairy products, are often sold on exchanges which specialize in the handling of a single product. Examples are found in the New York Coffee Exchange, Louisville Tobacco Exchange, and the New Orleans and New York cotton exchanges.[23] On some exchanges organized speculative trading in "futures" is an important feature; on others, there is none at all.

Another peculiarity of the central market is the auction company through which fruits in particular are sold. Auctions

[22] See Weld, *op. cit.*, Chap. XIII.

[23] It is probable, however, that the reason for this difference is not entirely inherent in the product, but is due to the fact that some cities are so located as to contain a central market for but a single product.

are of most importance when the product is perishable or comes to market in large quantities from distant areas. They are of some importance, particularly in Europe, in the sale of imported raw materials; and the largest fur auction in the world is located at St. Louis. The extent of the use of both auctions and exchanges varies greatly as between different products and different markets. In fact, a very large part of all agricultural products, both raw materials and consumption goods, is exchanged at the central market through private sale, even though the transaction may be made subject to the rules of an exchange.[24]

Jobbing Markets.—The main service of jobbing markets, which are also called secondary wholesale markets, and consumption wholesale markets, is to assemble products for the surrounding retail markets, that is, for sale to retail stores. Jobbing markets are operated on a smaller scale than are the central markets, do not play so large a part in the determination of prices,[25] and perform only those operations which enable them to supply their immediate clientele. In assembling the products which the trade requires, they serve to disperse products concentrated at central markets to various retail outlets. Thus apples are concentrated at central markets, thence dispersed to jobbing markets, and from these dispersed in turn to retailers. But this work in dispersing is simply another aspect of, and is conditioned by, the effort to assemble the various goods which retailers demand. Such a market may assemble goods from central markets, from other jobbing markets, from local growers' markets, and even directly from growers themselves.

As thus described, it is evident that similar markets are not found for raw materials, as these are not retailed. There is, however, a dispersion of raw materials from central markets to outlying secondary wholesale markets and manufacturing

[24] The exchange operations are discussed on pp. 361–362, the auction on pp. 87–88.

[25] See pp. 435–440.

centers which corresponds to the dispersion of single products from the jobbing markets. Raw cotton, for example, for use by northern mills is bought through New York dealers who have concentrated the ownership, if not the actual cotton, in New York, a central market, whence it is dispersed to dealers and mills in manufacturing centers. And grain owned by dealers in Minneapolis, Chicago, and other central markets is sold by them to outlying mills and to dealers in other markets, who in turn sell to manufacturers. The truest parallel, however, to the jobbing market, so far as raw materials are concerned, is the jobbing market for the manufactured products into which the raw materials are made.[26]

The Jobber.—The chief middleman of the jobbing market is the jobber, and it is his activity which largely determines the nature of that market. The amount of a product which his market will consume largely determines the market in which a jobber will buy. If it consumes large enough quantities to warrant purchases in car lots, he is likely to buy directly from the growers' market, in car lots sent from the local shipping point. At times a number of jobbers will combine in ordering a car, and pool the costs and contents of the car on an agreed basis. But in many markets, and for perishable products in particular, jobbers do not sell in large enough lots to warrant such large purchases—in this case they are likely to look to nearby central markets for their supply.

Some Cities Have Both Jobbing and Central Markets.—Although the distinction between the operations of a central market and a jobbing market is easy to draw, actual markets cannot be so readily divided. Some markets which are primarily jobbing markets also reship produce to other jobbing markets, and it is safe to say that all central markets do a jobbing business. Thus Boston is primarily a jobbing market, concentrating products for local consumption. But it also supplies the surrounding territory, in doing which it acts partly in the capacity of a jobbing market and partly in the

[26] See pp. 115–119.

capacity of a central market, shipping goods out to jobbers in surrounding markets.[27] It also serves as a central market for wool. New York is primarily a jobbing market for food stuffs of the farm, but it is a central market for grain, wool, and cotton, and for many imported products, such as rubber, coffee, and wool. In Chicago, Minneapolis, New Orleans, and St. Louis, on the other hand, the work of reshipping concentrated farm products to other cities and to foreign countries plays a much greater part than does the work of jobbing. But in each of these there is also a great consuming population and, hence, a large jobbing market. Furthermore, a city is likely to be a central market for but a few products, whereas it must usually be a jobbing market for all products consumed locally. Certain products are concentrated both for local consumption and for reshipment to other points, but there is assembled the much greater variety of all kinds of agricultural products which are consumed by the local population. Some cities are usually thought of, nevertheless, as primarily central markets, because through their location they have come to play an important part in the concentration and dispersion of a great variety of products.

But not only is it difficult to say that a city is primarily a central market or primarily a jobbing market: it is usually difficult to say that a particular market place within a city is primarily a central market or a jobbing market. This is because the middlemen handling the products do not confine themselves to any one class of business, but seek their sources wherever they seem best at the moment and sell their products wherever the best market offers, regardless of whether that be the wholesale middlemen in another market, or the local retail dealers.

The Retail Market.—Raw materials are usually exchanged in large lots on a wholesale basis. They are not retailed. Goods ready for personal consumption in their original state

[27] See *A Summary of the Market Situation in Boston*, The City Planning Board, Boston, Mass., June, 1915.

must, on the other hand, pass through the retail market. The retail market for these is found wherever final consumers make their purchases. The dealers of this market sometimes secure their products from the grower, thus forming a part of the growers' local market, but more often, they buy from central and jobbing markets. This is the final link in the chain of distribution of agricultural consumers' goods. The reader should again be cautioned, however, that many products of the farm are not sold to consumers in their original form, but must pass through one or more processes of manufacture, and in some cases will never reach ultimate consumers. Wheat, cotton, rye, barley, tobacco, live stock, for example, are all processed in some degree. The retail market for such goods is a market for manufactured products, and the jobbing market becomes a wholesale or jobbing market for manufactured goods—a market in which products are assembled for distribution directly from manufacturers rather than from middlemen in a central agricultural market, or from growers and growers' markets.[28]

Summary.—From the discussion thus far it has appeared that at least four important types of agricultural markets are discernible. But by no means all agricultural products pass through each. Raw materials are likely to be sold by the grower at his local market and thence shipped to the central market where they are sold to manufacturers. In some cases, however, growers sell directly to manufacturers, and in many cases the local merchant sells to a manufacturer without recourse to any central market middleman, or the central market middleman buys directly from the grower without recourse to an independent middleman at the grower's market. Products to be sold to ultimate consumers in practically the form in which they leave the farm are, however, very likely to pass through each of the four markets enumerated, going

[28] The problems of retailing farm products are so closely interwoven with the retailing of manufactured goods that the discussion of the retail market as a whole will be taken up in Chaps. XI and XII.

(1) through the local market, (2) to the central market, from thence (3) to a jobbing market, and finally (4) to the retail market. But it has been indicated that there are many variations from this four-step scheme. Growers sell directly to retailers, jobbers buy from growers and from local shippers, and, finally, central market middlemen buy directly from growers and often distribute directly to retailers, attending themselves to both the concentration and dispersion of the product to and from the central market.

CHAPTER V

MIDDLEMEN OF THE AGRICULTURAL WHOLESALE MARKET

A distinction has been made between central, or terminal, wholesale markets and jobbing, consumption, or secondary, wholesale markets. This distinction is a matter of degree, and the middlemen operating in each cannot be readily divided into middlemen of the central market and middlemen of the jobbing market. Nevertheless, just as the principal function of the central market is to collect produce from country shippers and growers at convenient points for later dispersion, and just as the principal function of the jobbing market is to assemble for retailers, so there are middlemen whose primary business is the collection of products and others who attend mainly to their dispersion and assembly. In fact, it is the presence of these middlemen which makes the market, and the nature of their activities determines its character.

Confused Nomenclature.—There is much confusion in the nomenclature applied to these wholesale dealers. Sometimes middlemen known by a certain name to the trade are no longer functioning in the manner the name seems to indicate: the same middlemen operate in different ways from time to time, and middlemen called by different names by the trade may be operating in the same fashion. It will, therefore, make the discussion more readily understood to start with the operations and business methods which are found, and to pass from these to the classification and nomenclature.

A. Operations.—There are three important operations in the wholesale market: (1) the concentration of products from

the growers or country shippers; (2) the dispersion of concentrated products to other markets, to factories, and to retailers, as a part of the function of assembly; and (3) speculation. Concentration and dispersion have been discussed. The speculative operations are performed by a class of dealers who make it their main business to buy in one wholesale market and ship or sell the product in a similar market, or to resell on the same market, wherever a chance for profit from a resale appears. Buying and selling when they believe the price is lower or higher than general market conditions warrant, they serve, through their operations, to equalize the price and supply as between various markets and between various seasons of the year.

There is, in the wholesale trade, one class of dealers, who are sometimes called "receivers," which is engaged in concentrating products from the local growers' markets and from other wholesale markets, foreign or domestic. Another class purchase from these receivers and in turn disperse the product to mills, factories, and, particularly, to retailers. That is, some dealers are engaged primarily in concentration and some are engaged primarily in dispersion. But there are many deviations from this practice. In fact, it is only in the largest markets that anything like this distinct cleavage is found. In smaller markets the goods pass directly from the receiving dealer to the retailer or manufacturer. That is, the same middleman is engaged in concentration and in dispersion and assembly. Nevertheless, many of the products which the middlemen of these smaller markets handle are bought by them from the large central markets. In so far as this is true, this distinction between receivers and those who disperse is maintained, but the concentrating middleman and the assembling middleman are located in different market places, and often in different cities.

Again, certain wholesale markets are engaged more largely than others in dispersing products which have been concentrated there for the purpose of redistribution to other points,

and some are engaged chiefly in concentrating products for local distribution. In the same city the former type of activity will predominate with products concentrated from the surrounding producing areas for which it serves as a primary market, and the other will prevail for products which are shipped in for consumption from areas not geographically tributary. The differentiation between middlemen who concentrate and those who disperse ~~has developed~~ because it usually proves more effective and more economical for a middleman to specialize.[1] The many deviations from this practice indicate, nevertheless, that it is far from generally recognized as essential. In fact, an individual dealer seldom confines himself exclusively to one or ~~the other~~ kind of operation. The middleman of the jobbing market may buy most of his products from a receiver at the central market, but if opportunity offers he does not hesitate to go over the latter's head to the country shipper or even to the producer, sometimes contracting for products before the growing season begins.

[1] It is of interest that the scale of operations in the produce market continues small. "The growth of larger organizations in the produce business has not brought about a proportionate increase in the size of the operating unit in Chicago. It has not given us enormous local concerns standing out in the business as Marshall Field and Sears, Roebuck do in their respective spheres, and financially capable of building for themselves the plant which would give them the maximum of technical efficiency. The point is, of course, that the big produce business grows by enlarging its contacts with many producing and many consuming points, and its life and growth are based upon constant and personal direction by men intimately and somewhat permanently connected with these diverse local situations. It does not admit of being reduced to a routine, which can then be multiplied into a great establishment, but must remain a network of small and personal places of business. Apparently there are fairly definite limits, under present conditions, to the advantages to be gained by increasing the scale of operations beyond a certain point. It is extremely doubtful that Chicago dealers will ever be in a position to furnish themselves with a really adequate equipment. They must look to the railways, the cold-storage companies, special terminal corporations, or to the city government."—E. G. Nourse, *The Chicago Produce Market* (1918), pp. 114–115.

The receiver in turn may sell chiefly to jobbers, but does not hesitate to sell to retailers if a suitable opportunity offers.

This failure for clear lines of demarkation to develop between classes of dealers is one of the features of the distribution of farm products which distinguishes it particularly from that of manufactured goods. With manufactured products there is a distinct tendency for middlemen to confine themselves to particular types of operation. Any departures therefrom are commented on by the trade, and frequently lead to trade "wars" upon such "irregular" dealers. Nothing of the kind is found in the farm market. The conditions under which farm products are marketed vary so from point to point, there are so many channels of distribution open to the grower and so many types of sale are found, that methods change constantly. Furthermore, because market prices continually fluctuate and many products quickly deteriorate, speed is important; and so there is no inclination on the part of farmers, dealers, or consumers to confine themselves to so-called "regular" methods of exchange.

Specialization of Middlemen by Products.—There is also a tendency for middlemen to specialize in the distribution of single products or classes of products. In the larger markets there seems to be a fairly distinct cleavage between middlemen handling the following classes of products: meat, fish and sea food, grain, cotton, wool, tobacco, fresh fruits and vegetables, dairy and poultry products, and the like. Even at local shipping points and in the smaller markets there is a tendency to such specialization. So many middlemen operate, however, in several of these lines that this should be looked upon simply as a general tendency.[2]

B. Business Relations.—In Chapter I a distinction was drawn between merchants and functional middlemen of ex-

[2] This situation in the produce trades is discussed in the *Report of the Federal Trade Commission on the Wholesale Marketing of Food,* pp. 27–30. See also L. D. H. Weld, *The Marketing of Farm Products,* pp. 14–16.

change. This classification is based upon the business relationship existing between the dealer and his customer. The merchant is the actual owner of the goods he deals in, and as such bears all of the risks and responsibilities of ownership. His profits result from his own trading. The functional dealer does not own the merchandise and does not bear the risks of ownership, but represents the buyer or the seller and is paid by him for his efforts in his behalf. It is common for the same middleman to operate in both ways.

(1) *Commission dealing.*—Those middlemen who act as intermediaries between country shippers and buyers in the central market are called commission merchants—although they are not merchants—or commission men, in the sale of grain, live stock, fruits and vegetables. They are called factors in the raw cotton trade, and merely buyers in some trades. They normally act for the grower or country shipper in the terminal market and neither buy nor sell on their own account. Sometimes they represent buyers rather than sellers. Their primary service is to know the markets in which their clients' products can be best disposed of. They are paid a fee or a commission for their services. Dealers usually operating on a commission basis frequently buy and sell on their own account. When doing so, they are, of course, not acting in the capacity of commission men.

(2) *Outright purchase.*—Dealers who buy outright are not clearly distinguished in the nomenclature of the central market. Those whose chief function is to collect from the growing areas are variously called "wholesale receivers," "wholesalers," —a term which is likewise applied to all dealers in the central wholesale market—"car-lot receivers", and "jobbers." The term "wholesale receiver" best expresses the function involved, is less liable to confusion than is the term "wholesaler," and is preferable to the term "car-lot receiver," because it is less restricted in its apparent meaning. As the jobber's operations are commonly considered to be confined to the assembly of products for sale to retailers, the term "jobber" is unsatisfactory.

The term "wholesale receiver" is not only the best, but it has already been introduced into the scientific literature of the subject.[3] Consequently, it will be used here.

Among the members of the trade and in popular discussions the term "commission man" is frequently used to include both the middlemen who actually work on a commission basis and those who buy and sell on their own account. This confusion is easily explained. In sending products from distant growers' markets to the terminal market the first method to develop has usually been the commission method. For reasons which will be mentioned presently there often follows a gradual change of method on the part of certain dealers.[4] They begin to buy and sell outright and may come in time to deal entirely on such a basis. But they continue to call themselves commission men and to be known as such. Despite this confusion of terms and of practice the two methods are distinct and are recognized as distinct in the trade. Consequently it is feasible to organize a nomenclature on this basis: a nomenclature which, moreover, conforms closely with trade usage as well as with that already adopted by students of agricultural marketing.

Commission Dealing.—The usual business of the commission man is to receive goods directly from the country. He does not buy, but endeavors to sell for his country client, usually in the terminal market in which he is located. Thus in the cattle trade the stockman or country buyer will consign a car or more of cattle to the commission man. When the shipment arrives at the central market, the commission man takes complete charge. (1) The cattle are divided roughly into groups, which conform to the demands of the buyers, after which they are driven into enclosures and the commission man, as the representative of the seller, has complete power (2) to sell the cattle and (3) to collect the proceeds for his client. After the stock is sold the commission

[3] See Weld, *op. cit.*, p. 80.

[4] See pp. 81–84.

man deducts the costs which he has paid, such as freight, feed for the stock, insurance charges where they are involved, and yardage and inspection fees, as well as his own commission for selling. He is usually paid a sum which is a percentage of the total sales or which is made up of a certain charge per unit sold.[5] The details which determine the amount and the nature of the deductions for costs and services by the commission man have usually been determined in advance by agreement between the receiver and his customer or by the established rules of the trade.

Some time necessarily elapses between the shipment and the sale of the goods, and many shippers are unable or unwilling to wait for their money until the returns would naturally reach them. It is the custom in some trades, consequently, for the receiver to advance a certain proportion of the estimated value of a shipment at the time it is sent. Cotton factors, for instance, frequently store cotton for shippers who are not ready to sell and advance money on the stored cotton.[6] This is in the nature of a loan on suitable security,

[5] These commissions range for different products between one and fifteen per cent of the selling price. The charge is usually less for car lots and a higher commission is charged for the sale of the more perishable products and for products for which no central market places exist in which buyers and sellers come together. Goods bought in bulk are sold on a higher commission than those purchased by grade or sample.

[6] They sometimes do more. Thus, "It is an established custom for him [the cotton factors about Memphis, Tennessee] to advance to the grower money to enable the latter to plant, cultivate, and gather his crop, such advances usually being made upon the basis of $15 per bale on the number of bales which the grower contracts to deliver to the factor. Upon advances so made the factor charges interest at the rate of 8 per cent. When the cotton has been ginned and, in accordance with the contract, delivered to the factor, the latter sells it and in settlement with the grower deducts his 8 per cent interest on money advanced, a commission of 2½ per cent, and expenses consisting usually of freight charges, drayage, storage, and insurance. Where all these charges attach to the handling of a bale of cotton by the Memphis factor the average, it is said, amounts to approximately $3 per bale."—*Interstate Commerce Commission Reports,* Vol. XXVI (1913), p. 590.

although the understanding is that the factor will eventually sell the goods for his client. When final payment is made the factor deducts, among other things, interest on the money advanced. Local shippers of grain commonly draw drafts on the purchaser for the full amount of the sale. In other cases, particularly when selling through commission men, they are allowed to draw up to a certain percentage of the estimated price.

Rise of Outright Purchase from Commission Dealing.—The commission method of dealing is almost always found when marketing is crude and undeveloped, when goods vary in quality, variety, and method of packing, when transportation facilities are slow and not dependable, and when market news is inadequate. Under such conditions dealers are usually unwilling to undertake the risk of buying the product outright. If they do buy they must pay a price low enough to offset the risk involved. The shipper, consequently, is likely to prefer to bear that risk himself for the chance of the higher price he may obtain through consignment. But as these conditions improve, as producers begin to specialize and to produce products of more uniform variety and perhaps to grade them by quality and variety; as transportation systems develop so that schedules can be depended upon, and the speed of trains increases; as refrigerator cars and other special equipment become adequate; as news of the needs of the market and of available supplies comes to be more accurate and more readily obtained—the risks en route and at the central market grow less, and consequently the possibility of outright purchase by the dealers located there becomes greater. But such improved conditions make outright purchase only more probable; they do not cause it to develop.

Among the causes that may compel the change from consignment to outright purchase are the conditions in the trade and the demand of shippers to be relieved of risk. Shippers very largely oppose the consignment method, or are suspicious of it, particularly when the scarcity of market news makes

them unable to follow the market closely,[7] or when they grow products which are likely to deteriorate before they reach the market, or which fluctuate greatly in price. They are likely to feel that they are not getting the top price, or that the dealer's deductions for grading, packing, or for unsalable products are too great—that the commission man is not dealing fairly with them.[8] They are more than likely, consequently, to patronize a dealer who will offer to purchase outright at the market price. This relieves them of the necessity of waiting for the returns and of the uncertainty and risk connected therewith. On the other hand, as the central market dealers are in the best position to know the needs of the market they sell in, and as they gain individual experience and as market conditions improve, they reach a place where they are in a position to bear the risks of merchanting and, in order to gain any increased trading profits which may result, prefer to operate that way. It is possible, also, that the increased interest of the dealer who has his own funds invested in the goods causes him to operate more effectively. Furthermore, since he is located in the central market, he is in a better position to determine market trends and, consequently, to carry the market risks.

These facts, coupled with the competition of commission men among themselves and with other classes of dealers for products to handle, or with which to supply their established trade, have undoubtedly been important in bringing about a change. Thus, in the produce trade, in order to procure just the kind and quality of products they require, the jobbers have often gone over the heads of the receiving middlemen and have themselves bought directly from the producer or country shipper, paying cash.[9] This has sometimes forced

[7] See *Report of the Federal Trade Commission on the Wholesale Marketing of Food*, pp. 40–42.

[8] See E. G. Nourse, *The Chicago Produce Market*, pp. 55 ff.

[9] Nourse, *op. cit.*, p. 51 ff., and *Report of the Federal Trade Commission on the Wholesale Marketing of Food* (1920), pp. 52–53.

the commission man to meet not merely the competition of other wholesale receivers but to contend with that of the jobbers as well. Again, in order to be assured of the kind of produce wanted receivers are often forced to get products from distant sources and are compelled not merely to pay cash, but even to guarantee a certain price before the growers will plant the crop. This is because the latter are unwilling to take the risk of that particular crop and its prospects in the distant market. Moreover, in time of shortage in his normal field of supply the dealer may need to enter growing sections in which he does not ordinarily buy, and to the growers of which he is not known. To compete with established houses he may be forced to pay cash. Sometimes the commission man has sold the greater part of a shipment on a commission basis, and rather than hold up the payment of the shipper until it is sold he buys the remainder himself. Finally, as particular dealers gain in financial power and are able as a result of increased reputation with banking houses to borrow funds, they become able to carry on their business on this basis, whereas before these fortunate conditions arise they must operate on a commission basis, in which less capital is required.

Both Business Relations Prevail in Most Lines.—Any of these causes may lead to outright purchase, and temporarily, at least, tend to confuse business methods. For during this change it is evident that both business relationships are likely to prevail in the same market and to be used by the same merchants. Likewise, the limited financial resources of new dealers coming into the field tend to perpetuate commission dealing. In most trades the two methods are found side by side, and the consignment sale is by no means losing ground in all trades. Thus in the cattle industry, the commission method prevails almost entirely. Because of the continuous market for live stock, its excellent organization, and the knowledge which shippers have of the market, and because of the efforts which have been made by the dealers' associations

to prevent sharp practices, this method appears to continue to give satisfaction, and the demand for change has not been great enough to bring it about. Well over two-thirds of the grain sold by country dealers is consigned for similar reasons,[10] and in periods in which prices are fluctuating greatly, or when the grain of a particular section is of very poor quality, dealers who ordinarily buy may be unwilling to chance the extraordinary risks which these conditions cause and so simply operate on a commission basis for the time being.

It seems that the continuance, side by side, of these two methods may prove a protection to the growers, because they can utilize whichever method suits them best, and the competition between the two classes of dealers tends to obtain good service from the commission dealers and good prices from the merchants.

Outright Purchase: The Wholesale Receiver.—Large quantities of products are now bought outright by merchants in central markets. It is to such merchants that we here apply the term "wholesale receiver," although the trade is likely to continue to call them "commission men" long after they have ceased to operate on a commission basis. The main function of both wholesale receivers and commission men is to concentrate the products from country shipping points at the terminal markets. The wholesale receiver, in buying outright, bears all the risk of marketing the product after it leaves the country shipping point;[11] when the dealer works on a commission basis, the shipper bears the risks.

Because of the uncertainties involved it seems that the outright purchaser would require a larger profit than that required by the commission dealer in the same trade. Probably

[10] *Report of the Federal Trade Commission on the Grain Trade,* Vol. I, pp. 144-145.

[11] In the case of sales in which the price is determined by the market price on the day of arrival, the dealer's risk begins on arrival.

this is true. But facts are not available for proving the case, and the following statement concerning the grain trade is of interest:

"Grain jobbing is a precarious business. Several grain jobbers suggested that in considering the jobber's profits attention should be called to the fact that about 10 per cent of the grain jobbers fail in business each year. The average profit of a grain jobber is about 1 cent per bushel on wheat handled, depending on the volume of his business, his knowledge of the market, and the movement of prices. As he is performing practically the same function as the commission man he can not expect to make on the average much more than the commission man, who, as stated, receives uniformly 1 cent per bushel for his services in the grain exchanges."[12]

The Broker.—The broker is another receiver who operates in much the same manner as does the commission merchant, except that he more frequently represents buyers in the central market than does the commission man, and seldom represents growers or country shippers. He usually handles goods in larger lots, performs fewer functions, exercises fewer powers, and so works for a smaller fee than does the commission man. Usually the broker merely gets in touch with the market sources for his principal and then must confirm prices and conditions of the contract before he can act; his powers of representation for his client are thus not usually so broad as ~~are~~ those of the commission man. His main function is to bring buyer and seller together.

When a broker represents a shipper he is sometimes called a shipper's representative. But the shipper's representative does not always sell; often his duties are to inspect the shipper's products when they arrive at the central market, the selling being left to other agencies. As many shippers' representatives work for salaries, it is evident that they are not

[12] United States Bureau of Labor Statistics, No. 130 (1914), (Retail Prices and Cost of Living Series, No. 9), *Wheat and Flour Prices from Farmer to Consumer*, p. 29.

true brokers.[18] Transactions on produce exchanges are commonly made through brokers.

Inasmuch as some dealers called "brokers" perform more functions and exercise more powers, and as some commission men perform fewer functions and exercise fewer powers, than are here indicated, it is frequently difficult to classify individual firms. The two types shade almost imperceptibly into one another.

The Jobber.—The main business of the jobber is to assemble goods for retailers. In order to be supplied with the products which his trade demands, the jobber is on the constant lookout for any source of supply that will give him the desired products of the proper quality and quantities, at the time wanted and at the lowest price. But although he is constantly on the lookout for the best source of supply, most of his purchases are made from receivers in the central market. This is particularly true in the case of products coming from a distance, and such products are usually in the great majority. Even crops grown locally, such as fruits and vegetables, can usually supply the local market for but part of the season. Before and after the local season they must be imported from sections in which the crops mature earlier and later. It is true of practically all markets that but few of the products they consume are grown locally and that when

[18] The term "broker" is also applied in the fruit trade to local representatives of wholesale receivers and commission houses who go to the country shipping points and buy or take on consignment for their houses the products of the growers. They usually work on a commission basis, the commission being paid by the house they represent. The term "solicitor" is also applied to these local representatives of terminal market middlemen, particularly when they work on a salary basis. The work of such middlemen must not be confused with that of the dealer here described.

The broker of the fruit and vegetable trade is described in J. H. Collins, J. W. Fisher, Jr., and Wells A. Sherman, *Methods of Wholesale Distribution of Fruits and Vegetables on Large Markets,* U. S. Department of Agriculture, Bul. No. 267 (1915), pp. 11–14.

so grown the supply is frequently insufficient even during the height of the season.[14]

Jobbers do not usually confine themselves to a single source of supply but depend now on one source, now on another. Thus, produce jobbers in some of the outlying markets in the city of Chicago buy much of their produce directly from the central market on "South Water Street"; others, however, buy from growers,[15] and either may buy from time to time from the other source. Jobbers in the smaller cities likewise buy both from nearby and distant growers and from receivers in central markets.

The Auction Company.—An agency of considerable importance in the distribution of perishable products at central markets is the auction company. The function of an auction company is to furnish a place and a business mechanism through which perishable products shipped from great distances in large quantities can find an immediate market. The company supplies a building to which the goods are taken and in which samples—called "parts of marts"—can be displayed. A daily catalogue is printed naming the goods offered for sale on that day, and auctioneers are provided. Sales are made on the basis of samples representing each lot of goods. After the sales are made the company attends to the collection and remittance of the proceeds. The auction company represents the shipper and sells for him, or rather for the wholesale receivers and commission men who handle the shippers' produce in the central market; and the buyers or their direct representatives are there to bid on the goods as they are offered for sale. Only wholesale middlemen are usually

[14] It has been estimated that not over 5 per cent of the produce consumed in the New York area is grown within the trucking radius (50 miles). *Report of the Federal Trade Commission on the Wholesale Marketing of Food,* pp. 202–203. See also L. D. H. Weld, "The Food Supply of the Iron Range" in Weld and Others, *Studies in the Marketing of Farm Products;* Studies in the Social Sciences, No. 4, University of Minnesota (1915), p. 109.

[15] See E. G. Nourse, *The Chicago Produce Market,* pp. 14–26.

represented as sellers at such sales, although at times large shippers are present. Jobbers are the chief purchasers, but regular retailers and such venders as hucksters and push cart men sometimes buy. The fees for the services of the auction companies usually consist of a commission charge to the seller.[16]

Middlemen Who Speculate on Quick Price Changes.—The middlemen thus far discussed are mainly engaged in concentration or dispersion. A third group operates mainly in the central market. Middlemen of this kind seldom hold products for long, but make it their business to watch prices carefully for a chance to make speculative profits from rapid transactions. When prices are lower than they believe conditions warrant, they buy, selling later at the advanced price, in case they have properly judged the market. Or they buy in one market when prices are a little lower than in another and sell quickly in the other market before prices have again become equalized. Their profits on individual sales are usually small, the very nature of their business tending to keep the markets in close adjustment. For when the price in general or prices in a given market get out of line their purchases and sales tend to bring prices back to normal, and hence to eliminate entirely the chance of profit from such transactions. Operations of this kind are mainly speculative, but they serve to keep prices at a point near to that which market conditions seem to warrant. This helps to keep large dealers from forcing prices up or down and to prevent extreme price fluctuations.[17]

Functional Specialists.—There are other market agencies highly specialized by function. It has been shown that mar-

[16] Detailed discussions of auctions will be found in L. D. H. Weld, *The Marketing of Farm Products,* pp. 53–55, 124–141; E. G. Nourse, *Chicago Produce Market,* pp. 32–38; *Report of the Federal Trade Commission on the Wholesale Marketing of Food,* pp. 56–59. In Europe many raw materials, such as wool and rubber, are auctioned. Wool is sometimes sold at auction in the United States.

[17] See pp. 372–375 and 440–443.

keting consists mainly of buying and selling and of the processes of transportation and storage. The middlemen so far discussed have dealt mainly with buying and selling and in so far as they have carried or stored goods it has been incidental to that function. But there are agencies which specialize entirely in transportation, storage, risk-taking, and financing. These are not middlemen according to the classification of Chapter I. They perform services which buyers and sellers would otherwise have to perform, just as the producer and the consumer would have to attend to all the details of buying and selling if there were no middlemen.[18]

[18] Examples have already been given in Chap. I, and need not be mentioned again at this point. It will also be unnecessary to discuss now the retailer of agricultural products, for the retailing of farm products is so similar to the retailing of other products that it can be left for later consideration.

CHAPTER VI

MARKETING RAW MATERIALS

I

The three preceding chapters dealt with the marketing of farm products, whether used as raw materials or foods.[1] This chapter will consider the marketing of raw materials, as illustrating the marketing of production goods. Every manufacturer has both a buying and a selling problem; and this chapter treats what is perhaps the most important part of the former—the purchase of raw materials.[2] The problems involved in marketing semi-manufactured production goods will not be specifically discussed. But the omission is not serious, since, from the point of view of the purchasing manufacturer, the problems are similar to those mentioned in this chapter, and the problems of the selling manufacturer are discussed in later chapters.

Small Scale Production of Raw Materials.—Raw materials are the products of the farm, forest, mine, and sea before they undergo the manufacturing processes which prepare them for use. Such materials are used in large quantities by individual manufacturing plants, but they are ordinarily pro-

[1] Foodstuffs when they are to be preserved, packed, canned, dried, or otherwise processed on a commercial basis will be considered as raw materials; after those processes have been completed, they will be considered as manufactured products.

[2] On the general subject consult Arthur E. Swanson, "Determining the Purchasing Policy," *Administration,* Vol. 2, No. 5 (Nov., 1921), pp. 616–622; H. B. Twyford, *Purchasing* (1919), and Charles S. Rindsfoos, *Purchasing* (1915).

duced and extracted from nature on a small scale. Furthermore, the sources of raw materials are often at a great distance from individual factories and the centers of manufacture. Such products must, consequently, be collected from small producers and concentrated in manufacturing centers and at manufacturing plants. Farm products in particular—fruits, vegetables, grains, sugar beets and sugar cane, tobacco, coffee, forage crops, cotton, rubber, wool, live stock—are produced on a small scale by thousands of independent growers. Even a large plantation is small scale when compared with a modern factory. Among the extractive industries, such as mining, lumbering, fishing, large scale operation is more common. But even here a large volume of the total production is small scale.

Transportation Problem.—Transportation costs usually determine whether materials will move to the factory in their crude state, or whether there shall be at least a degree of processing at the source. The location of factories at a considerable distance from the source of their raw materials is a common phenomenon.[3] But, in the case of very bulky products, of products in which there is a large percentage of waste, and of products extracted on a large scale, a rough processing, or even complete processing, may take place before the product is moved very far toward its place of ultimate consumption. Lumber mills, for example, are usually located at the forests, although the furniture and houses made therefrom are constructed and manufactured far away in the centers of consumption and manufacture. This is the case because the market for lumber is definitely limited by the cost of its transportation and less than 50 per cent of the cubic

[3] Frequently these factories are concentrated in a few sections of the country. Common illustrations are the woolen and cotton mills of New England, the shoe factories in Massachusetts, the automobile plants in the Detroit section, etc. See the *United States Census of Manufactures* (1906), Vol. I, Chap. XII; and Malcolm Keir, *Manufacturing Industries in America* (1920).

volume of the tree reaches the market in the finished form.[4] Ores are frequently partially refined near the mines. This is particularly true when a long expensive rail haul is involved. The reduction of iron ore to metal, for example, is frequently undertaken where the ore, or other raw materials—fuel and flux—are found. The pig iron is easily shipped in bulk and is of sufficient value to warrant a long haul, whereas it may prove too expensive to haul the ore, the fuel, or flux, for similar distances. In this way the cost of transportation is reduced. Sugar beets are completely processed where they are grown. Only one-eighth of their weight can be extracted as sugar. This makes it necessary to place the refineries in the beet-growing sections; otherwise the expense of transporting the raw materials to the factory would make the costs much higher and prevent competition with lower cost refineries.[5]

Where raw materials and finished products are both very bulky, as is the case in the cement, brick, and tile industries,[6] there is a tendency for the industry to be operated in a purely local way. When there is a suitable supply of such raw materials at hand a local plant, even though operating on a relatively small scale, can far underbid more distant producers. Consequently, although a very high proportion of such materials is processed near the final market, it is also made from local materials.[7] When the raw material is perishable, there is, likewise, a tendency to manufacture near the source of supply. Examples are found in the localization of the salmon canneries in the Northwest, and of the vegetable and fruit canning industries in districts where there is a sufficient supply of materials to warrant the establishment of canneries. The

[4] R. C. Bryant, *Prices of Lumber,* U. S. War Industries Board, Price Bul. No. 43.

[5] *Report of the Federal Trade Commission on the Beet Sugar Industry in the United States* (May 24, 1917), pp. 152–153.

[6] Heinrich Ries and Henry Leighton, *History of the Clay-Working Industry in the United States* (1909), p. 6.

[7] For a good recent discussion of the reasons for the localization of industry the reader is referred to Keir, *op. cit.,* Chap. III.

packing of oysters in Baltimore, and the wine industry in California are other examples.[8]

Need for Standardized Materials.—In addition to his need for a large supply, the manufacturer desires raw materials of the exact quality his finished product demands. Furthermore, they must be made available for use as needed. But individual producers and even whole producing areas cannot always meet these demands. Raw materials are by no means uniform in quality, and both the quantity and quality of materials produced, as well as the materials used, vary from season to season, from producer to producer, and from manufacturer to manufacturer. Raw materials must be taken as nature supplies them, and man is unable to exercise a sufficient influence to avoid variations in either quality or quantity.[9] Agriculture and many extractive industries, furthermore, are seasonal in nature, whereas the manufacturing plants which utilize their products prefer to operate continuously. Even when the demand for the manufactured product is seasonal, production conditions usually make it imperative that the factory operate at a uniform rate of production throughout the year if that is possible.

The demand of manufacture for materials uniformly of particular qualities arises in the first place from conditions

[8] The bulk of the raw products and the waste involved are, however, likewise important factors in each of these cases.

[9] An extreme illustration of the failure of producers to supply raw materials of uniform quality is found in the case of American wool: "The lack of uniformity in American breeding methods perhaps does more than any other one thing to make close or accurate grading of our wool impossible. Neither wools from any given locality, nor even separate clips have a closely uniform character. . . . When the Wool Exchange attempted to list and prescribe a minimum number of standard classes, it was unable to reduce the list to as few as 200 main classes, and the relations between these were very hazy. This is in sharp contrast with the relatively simple grading systems for cotton and wheat, and also shows a marked difference from conditions in either the English or Australian wool-auction warehouses."—Paul T. Cherington, *The Wool Industry* (1916), p. 67.

in the market for the finished products—the need to supply a commodity of uniform quality to the trade. The tendency for manufacturers to sell by specification, by brand, trade name, or trade-mark makes this particularly important.[10] An additional cause for this demand for carefully standardized materials is the fine adjustment with which some machinery is now set—a condition which makes it imperative that the proper materials be used.

"With the increase in the spinning of fine counts and in the manufacture of fine goods, it has become necessary for the manufacturer to discriminate in the quality of cotton which he buys, and in the manufacture of coarser yarn and cloth the machinery adjusted for a certain grade of cotton cannot be operated advantageously on a lower grade, while a higher grade adds a needless expense. The spinner must also be careful in his selection of the raw cotton because of the preference of the operatives to work continuously upon the same grade. If an attempt is made repeatedly to substitute an inferior grade, it is difficult to retain the better class of operatives." [11]

Merchandising Demand for Standardized Materials.—But another, and perhaps in most cases a more important reason for the demand for standardized materials, is what might be called a merchandising demand. Manufacturers prefer to be able to purchase just the grade of materials they need to use. This is because they do not wish to go to the trouble and expense of grading materials as they come from the producer, and of marketing the surplus which they cannot use. Neither do they care to bear the extra cost of buying materials which they can not use, even though they may be able to resell them. Nor do they wish to bear any greater risk of price changes or of physical deterioration than is involved in purchasing the minimum amount of the exact quality of materials demanded by the factory.[12]

[10] See pp. 402–406.

[11] M. T. Copeland, *The Cotton Manufacturing Industry of the United States* (1912), p. 184.

[12] Standardization by market agencies does not always complete the

Inspection.—So important is it to have raw materials possessing proper characteristics that in many cases manufacturers are not content with buying raw materials on grade alone. Often, as with wheat, the actual value of the product for manufacturing can not be determined with sufficient accuracy by the ordinary methods of grading; therefore a careful inspection and laboratory analysis of the product is made in the interests of the buyer.

"The distinctive value of hard winter wheat . . . lies in the relatively high per cent of gluten it contains. . . . The higher the percentage of gluten in the wheat the more desirable the flour is for bread-making purposes. . . ."

. . . .

So important is the content to the millers in determining the value of the wheat for milling purposes that "in several of the large grain handling cities there are laboratories devoted to a scientific analysis of wheat where samples can be submitted and the constituent elements of the grain carefully determined. . . .

. . . .

"Ordinarily the lower the test weight of wheat . . . the greater is the proportion of feed and the less the proportion of flour; consequently, more pounds of No. 3 than of No. 2 wheat are required to make a barrel of flour. This explains why No. 3 wheat is lower in price than No. 2 wheat, though both are bought at 60 pounds to the bushel." [13]

A further reason for such inspection is the opportunity for fraud, particularly when goods are purchased by grade or sample through private agencies. The purchase of rubber illustrates this last point. Rubber is purchased from sample, and as with any article purchased in this way, the chance

process. Wool fleeces, for example, are graded by the merchant, but the fleeces are also "sorted" at the factory because each fleece is composed of a variety of staples of different qualities. Cf. Report of the Live Stock Commissioner, Department of Agriculture, Dominion of Canada (1911), *The Sheep Industry in Canada, Great Britain, and the United States*, pp. 118–123.

[13] United States Department of Labor, Bureau of Labor Statistics, Bul. No. 130, *Wheat and Flour Prices from Farmer to Consumer* (Aug. 15, 1913), pp. 16, 31, 34.

for fraud is very great. Experts, therefore, must inspect the bulk of the rubber that comes into a plant to make sure that it is up to sample.[14]

The Benefits of Grading.—The considerations previously mentioned give well graded products a certain value over those which are not graded. In fact it has been shown that a greater premium is frequently paid for graded products than the advantages of standardization would seem to warrant. This is an incentive to those who produce or market such products to grade them carefully in order to take advantage of this enhanced price. A still further reason for grading is that it facilitates contracts for future delivery, placing them upon a known and definable basis.

Concentration of Raw Materials.—From the conditions that have now been discussed—the need of the manufacturer to procure a supply of products of uniform qualities, as needed, from producers operating on a small scale and unable to meet those demands individually, or even from local supplies—it follows that the collection and concentration of raw materials plays an important part in their marketing. This concentration serves a different purpose from the concentration of farm products for personal consumption. With the latter, concentration precedes dispersion to small consumers and occurs because it facilitates such dispersion.[15] With raw materials concentration is necessary because they are used in large quantities by factories, which, furthermore, are often localized. Concentration also facilitates grading. This is due to the fact that grading is best performed on a large scale; consequently, products produced on a small scale must be brought together in large quantities before they can be satisfactorily graded. As a result of these conditions collection at local producers' shipping points, and sale to, or through, concen-

[14] The B. F. Goodrich Rubber Co., *A Wonder Book of Rubber* (1917), p. 27.

[15] See pp. 39–40.

trating middlemen at central markets, are important steps in marketing most raw materials.

The Importance of Middlemen.—As a rule the manufacturer does not find it to his advantage to buy from producers, or even from producers' local markets.[16] As has been shown, this is on account of the fact that direct purchase would involve the expensive process of buying by inspection or in bulk rather than by grade. Or it may necessitate the purchase of many more products than he could use. In this case the manufacturer would be forced to market the surplus for which he had no use. If he did not care to purchase products unsuited to his needs the manufacturer would have to keep in touch with many producers in order to procure a sufficient and suitable supply. To operate in any of the ways suggested would be laborious, expensive, and unsatisfactory to the manufacturer, as well as to the grower or local dealer of whom he purchased. Thus we find, for example, with country hides:

> "Each tannery, however, as a rule, specializes in certain kinds of leather, and consequently must have uniformity in its supply of hides and skins. Since the tanner is not in a position to handle all kinds and classes of these materials, some central collecting and classifying agency is necessary."[17]

The Broker and the Merchant.—The broker and the merchant render important assistance to the manufacturer. It is their office to know the market. They must know not merely prices and general conditions of demand and supply, but what qualities of product particular manufacturers desire. They must know, too, where these can be secured, and in the case of the merchants, they must themselves procure them, sometimes before they are demanded or needed by the

[16] This point is discussed on pp. 39–42.

[17] United States Department of Agriculture, Farmers' Bulletin No. 1055, *Country Hides and Skins, Skinning, Curing and Marketing* (1919), p. 46.

manufacturer.[18] The middleman frequently buys by inspection, grades the product, and then sells to the manufacturer the exact qualities he desires. This sale to the manufacturer is frequently made by description, although final payment may be made only after the product has been inspected. In other cases the sale to the manufacturer is made only after he has inspected a sample of the commodity.

Even the larger packers purchasing, as they do, thousands of head of live stock daily do not purchase directly from the grower, or even from the country shipper to any great extent, but depend mainly upon the commission men who operate in the stockyards in the central markets. Large rubber factories, likewise, use brokers. And although they have their own buying organizations through which they purchase at the plantation large quantities of the rubber which they use, they obtain the greater part of their supply from middlemen at the great local points of concentration, such as Singapore and Pará, and of importers or brokers at the European auctions or in the New York rubber market.[19] Enormous quantities of raw cotton for the use of the mills which produce fabric for use in making automobile tires and other products, are bought by the tire manufacturers themselves. But it is purchased almost entirely of the middlemen in the raw cotton markets. And some of the industries using the products of

[18] "The functions of the eastern wool merchant, so far as the domestic wools are concerned, resolve themselves into two main tasks. The first is the purchase of large blocks of high-grade 'territory' wools, and the purchase or marketing on commission of numerous small lots of medium or low-grade 'fleece' wools. The second task is the assembling of these wools, grading them, and storing them in lofts at the chief buying centers for eastern mills, ready for purchase in graded lots for delivering in quantities and at prices to suit their manufacturing customers."—Paul T. Cherington, *The Wool Industry* (1916), p. 64.

[19] "Only the largest manufacturers do any direct buying. The market is so changeable and its operation requires so much capital that manufacturers have found it cheaper to buy through dealers [merchants] and brokers."—The B. F. Goodrich Rubber Co., *A Wonder Book of Rubber* (1917), p. 26.

the extractive industries buy through brokers, and selling agents. This is true with regard to much of the copper, lead, zinc, clay for pottery, and lumber which is purchased by manufacturers. Some iron ore is likewise purchased through brokers.

The Need for a Continuous and Assured Supply of Raw Materials.—But the manufacturer not only wants particular qualities or grades; he must be assured of a ready supply. Modern manufacturing involves such large fixed investments and the morale of the employees depends so much on regular and permanent employment that business men endeavor to operate their plants continuously. This is true even when the consumption or sale of their product is highly seasonal. And of even greater importance is the need for manufacturers to meet their own contracts for delivery and to be prepared to deliver products as their own market demands.

Methods of Assuring a Supply of Raw Materials.—There are four important means by which manufacturers may be assured of their supply of raw materials at a reasonable price:

(1) They may make a series of purchases to meet more or less immediate and specific needs, depending on knowledge of the market and the good will of supply houses toward them to make the supply continuous.

(2) They may contract for deliveries of materials in sufficient quantities to meet their needs for a considerable period of time.

(3) They may buy a supply sufficient to cover a large part or even the entire amount of the season's requirements.

(4) They may control the source of supply through ownership, lease, or contract.

(1) Under Common Conditions.—Most manufacturers purchase a part or all of their stocks as needed from day to day, week to week, or month to month. The amount purchased at any one time is governed by such questions as quantity

discounts, datings, transportation conditions, storage space, and financing. Such manufacturers depend for a continuous supply upon purchases in the open market as the need appears, or on contracts for delivery in the immediate future. They rely for the success of this policy upon their knowledge of the market on the one hand and on the good will of the supply houses on the other. Meat packers depend on making purchases of live stock from day to day at the stockyards, and manufacturers of corn products buy largely upon the cash corn market. Many manufacturers who buy important raw materials by other methods secure supplies for their power plant, factory, and office in this manner.

The good will of supply houses is important to those who buy in this way. "Taking care of one's customers" plays an important rôle in any market, and this is equally true in transactions involving raw materials. A manufacturer who has the good will of those from whom he buys, whether producer, broker, or merchant, and who buys of the best houses without dividing his purchases among too many of them, is likely to find that in times of threatened shortage his supplier will live up to his contracts, give him warnings of advances so that he may stock up, or in case of actual shortage see to it that he is kept stocked with necessary materials.[29] It is in such times that the good purchasing agent is cared for. If he has antagonized his suppliers by dishonest or despicable methods, if he has gained their ill will through unfair treatment, he is sure to suffer in times of shortage. On the other hand, if he has gained their good will, he may not only receive his goods in sufficient quantities but they may even refuse to exact the "pound of flesh" which the market would warrant.

The great majority of raw materials are purchased in this manner, i. e., on the spot market, or through contracts for delivery in the near future. To a very large degree purchases of each class are made through middlemen. The manufacturer

[29] A. E. Swanson, *op. cit.*, pp. 616–617.

depends upon the middlemen to seek out sources, to purchase supplies in advance of actual demand, to grade them, and to have them ready for use as needed. The great staple agricultural products in particular are bought chiefly of middlemen, either directly of central market merchants, or through functional dealers from these merchants or from local shippers. The manufacturing purchasers of wheat, corn, and other cereals, cotton and wool, and live stock, are all chiefly dependent upon the foresight of dealers for their supplies of raw materials.

An adequate supply of raw materials often assumes such importance that the manufacturer is unwilling to place reliance on his knowledge of the market or on the good will of supply houses. In such cases he may contract for the future delivery of important materials, he may buy in advance a sufficient supply to cover a considerable portion of time, or he may actually gain control of a source of supply. Each succeeding method gives more certainty than the preceding that the goods can be procured as needed.

(2) Contracts for Future Delivery.—The contract for the future delivery of important materials is, together with purchase in the open market or on short time contract, the means used by the average manufacturer in securing raw materials and supplies. Which is used in greatest degree depends on the practice of the trade, the estimate of market conditions, and the scarcity of the product. Flour mills, for example, can buy wheat in the open market, but they often purchase for future delivery, so as to protect themselves against advances in the price of wheat which may eliminate their profit on flour which has been sold on the basis of lower-priced grain.[21] Semi-manufactured production goods, such as automobile parts and accessories, are also commonly contracted for in advance.

Contracts for running delivery are also common. Crude petroleum is sometimes bought by refining companies under

[21] See pp. 368–369.

contracts running for a number of years, and so almost amounts to the control of the source.[22] Coal is often bought in this manner.

"Contracts are generally made (1) for a specified quantity to be delivered over a stated period and at an agreed rate per day, week, or month; (2) for a stated quantity per week or month for an indefinite period; (3) for the requirements of the consumer; or (4) for the output of the mine. . . . Contracts specifying a definite period of time usually cover a year . . . sometimes . . . 5, 10, or even 20 years or more."[23]

Sugar factories make annual contracts with farmers, and sometimes contract with them to grow beets on a certain number of acres each year, for from three to five years. The contract binds the farmer to produce under the supervision of the sugar company's agriculturist and binds the company to take the beets at stipulated base prices, the actual price varying with the quality.[24]

(3) **Purchase of the Season's Supply in Advance.**—The supply of raw materials often assumes such importance, however, that the manufacturer is unwilling to place reliance on contracts, knowledge of the market, or the good will of supply houses. And for such, to buy a sufficient supply far in advance of the actual need for processing is often the best solution of the problem of supply. It is true that outright purchase in advance of need and contracts for future delivery commonly serve the same end. But the purchase and storage of goods

[22] *Report of the Federal Trade Commission on the Petroleum Industry of Wyoming* (1921), pp. 36–37.

[23] C. E. Lesher, *Prices of Coal and Coke,* War Industries Board, Price Bul. No. 35 (1919), pp. 18–19.

[24] For a complete contract see George K. Holmes, *Systems of Marketing Farm Products and Demand for Such Products at Trade Centers* (1913), Report No. 98, U. S. Department of Agriculture, pp. 151–2. This report discusses the types of sale prevalent with most agricultural products, and although now several years old it is still valuable. See also Federal Trade Commission, *Report on the Beet Sugar Industry in the United States* (1917), pp. 153–163.

is sometimes made necessary because supply houses will not contract for future delivery. Another important reason is that contracts for future delivery do not always assure delivery. The seller may be unable to procure the goods or he may even refuse, directly or indirectly, to deliver. In times of shortage contracts are frequently cancelled, changed, and ignored.

Cotton and woolen mills usually purchase their supplies of raw cotton and raw wool considerably in advance of their needs. The manufacturers of clothing who use the product of the cloth mills likewise purchase in advance of immediate needs. In times of shortage, or of threatened shortage, manufacturers often protect themselves in this way. When they have orders for future delivery they may also stock materials in advance, so as to avoid buying at a later date when prices may have advanced, but after their finished product has been sold on the basis of a lower price. In such cases the losses that would result from an increased price for an important raw material, or even from the complete failure to procure it, might prove greater than the added cost and inconvenience of carrying a stock in excess of immediate needs.

A further reason for carrying larger stocks than current processing demands arises out of quantity prices and carload freight rates. Many products are sold at lower prices when purchased in quantities, and carload freight rates are usually much lower than less-than-carload rates. A final reason for stocking in advance is speculative in its nature—the feeling that a low point in the market has been reached, and consequently that a speculative profit will be netted from stocking in advance of current needs. Although this reason sometimes affects the buying policy it is less important than the other causes which have been mentioned.

Disadvantages of advance contracting and purchase.—These policies of contracting for future delivery and of stocking goods in advance have grave disadvantages. One may not know what quantities of raw material will be needed be-

cause he cannot judge the market so far in the future, or the market may change and the supply prove to be too great. Even when contracts for the sale of the finished products have been made, if prices fall or the market for the finished product declines, those who would normally buy the manufacturer's merchandise may find themselves unable or unwilling to buy at the contract price. Contracts amounting to millions of dollars are cancelled each year, and in times of falling prices this practice becomes a widespread evil. A manufacturer who has purchased or contracted for his supplies will face grave difficulties under these conditions. Again, the price paid may prove to be too high, or the quality bought may not be that which the market demands. Often, too, it is impossible to buy a large supply without bidding up the price to a point which would prove a handicap in price competition in the sale of the final product. Furthermore, important problems of storage, financing, and risk have also to be solved when this method is used.

Many raw materials are difficult to store. Soft coal is liable to spontaneous combustion, corn to heat, wheat to bin-burn. Insurance is often costly, and expensive warehouses may be required. If storage space has to be provided especially for this purpose, it is likely to be used at less than capacity through most of the year. But of greater importance is the necessity for tying up funds in surplus supplies. It requires large capital or the ability to borrow in large amounts. Many manufacturers, however, have neither funds nor credit in sufficient amount, and banks are loath to loan on raw materials purchased far in advance of manufacture and not readily salable in case of a declining market, unless some adequate means of hedging is available.[25] The risk, likewise, of loss from deterioration, or a falling or slacking market, deters manufacturers themselves from this course. For as we have seen, even though they may have contracted far in advance

[25] Many means of hedging are, of course, available. Where this is possible such risks are in part, at least, eliminated. See Chap. XVII.

for the sale of their product, the contract may be cancelled, or the purchaser, because of the declining market, may be unable to pay. It is, nevertheless, a method commonly used, one which is frequently adopted in normal times, and one which is widely used in times of a shortage in the supply of materials, or in times of abnormal demand for finished products.[26]

Protection through hedging.—The problems involved in advance purchasing are sometimes shifted, in part, by means of the future market for the raw material. Copeland describes the importance of hedging in relation to advance purchases in the cotton industry:

"The mills found it advantageous in the first half of the nineteenth century to buy their cotton early in order to make sure of their supply and also to have a basis for price quotations. With the cotton in their own warehouse they could quote prices for cloth with less risk of loss. The development of organized speculation, with its steadying effect on prices and opportunity for hedging, has made this factor less potent at the present time."[27]

That is, as the future market for raw cotton has developed, it has become possible for manufacturers to substitute, through hedging, a contract to deliver materials for an actual advance purchase or for the purchase of current supplies as needed from time to time. The need for advance purchase continues, nevertheless, even in this case, for,

"the manufacturers of the highest grades ordinarily buy at an early date a larger proportion of their total supply than those using ordinary staple. The former wish to exercise a wider choice in their selection and also to make sure of an adequate quantity. The demand for long staple cotton is frequently so

[26] Even firms which stock only for current needs usually have on hand a larger supply of materials than is absolutely necessary, chiefly because experience has shown that they must not run too close to the line lest deliveries fail.

[27] M. T. Copeland, *The Cotton Manufacturing Industry of the United States*, p. 182.

great that the manufacturer who delays is unable to obtain the quality which he desires, or he can secure it only at a very high price."[28]

In explaining the presence of local grain elevators owned by milling companies, the Federal Trade Commission shows that considerations which are similar to those found in the cotton industry operate to some extent in the flour trade, and have caused some of the large milling companies to own and operate lines of local elevators, in order to insure a sufficient supply of grain of the requisite quality.[29]

(4) **The Control of Sources of Supply.**—Some manufacturers who are large and financially powerful go even further in the endeavor to secure a suitable supply of important materials and establish a close business relationship with, or control over, important sources of supply. This is particularly true when the supply is limited or is so located that it can be easily monopolized either by a competitor or the manufacturer himself. Monopolization by the competitor might leave the manufacturer with no materials, or force him to pay an exorbitant price for them. If he gains control himself, he is assured of a supply and may, of course, squeeze less fortunate competitors. A desire to monopolize the supply or to gain the distributive or the productive economies of integration are often important considerations; they may in fact sometimes be of the most importance. But the necessity of an assured supply of raw materials of the proper grade, and at a reasonable price is usually predominant.

The ownership of clay beds by brick and tile plants;[30] the ownership and leasing of ore lands by large steel corporations, and the integration between various "steps" in that in-

[28] M. T. Copeland, *op. cit.*, p. 180.

[29] *Report of the Federal Trade Commission on the Grain Trade,* Vol. I, *Country Grain Marketing* (Sept. 15, 1920), pp. 78–9.

[30] Heinrich Ries and Henry Leighton, *History of the Clay-Working Industry in the United States* (1909), pp. 56–7.

dustry; the ownership and operation of a steel mill and of a railroad by Mr. Ford—are all examples in point.[31]

"The International Harvester Co., either directly or through subsidiary companies, manufactures or controls the manufacture of practically all the raw mateials it uses with the exception of paints. It owns iron ore and coal properties and operates iron, steel, and coke plants. One of its subsidiaries, the Wisconsin Lumber Co., owns extensive timber property and produces pole stock and other materials. The Harvester Co. has also special facilities for obtaining from the Philippine Islands and Yucatan Manila and sisal fiber used in the manufacture of binder twine. In addition, the company owns and operates several small industrial railroads. Through the foregoing and other auxiliary operations the International Harvester Co. is able to obtain most of its raw materials at production costs. This gives the company a large advantage, as few of the other companies control their raw materials."[32]

It is not merely an "advantage" for the Harvester Company to obtain new materials at production costs, but it would seem that it is a necessity for such an immense organization to be assured of a constant supply of essential raw materials. The importance of such assurance is clearly shown in the history of the organization of the United States Steel Corporation. The competing groups integrated various steps in the industry by purchase and lease and through new building operations. Their chief aims appeared to be to assure a market for their finished product and a source of supply of their raw materials. Similar motives caused integration among the "independents."

[31] If we may consider material to be carried as a raw material to railroads it is interesting to know that some of the railroads in the anthracite coal region, such as the Reading, first gained control of the mines for the purpose of assuring themselves of the coal traffic. See Eliot Jones, *The Anthracite Coal Combination in the United States* (1914), pp. 29 ff.

[32] *Report of the Federal Trade Commission on the Causes of High Prices of Farm Implements* (May 4, 1920), p. 49.

"The great firm of Jones and Laughlin, at Pittsburgh, makers of structural steel from materials of their own mining, are as independent as the Trust, into which they could not be induced to go. The Lackawanna Steel Company has a magnificent, new, and thoroughly modern plant at Buffalo on the shore of Lake Erie, where the ore steamer can discharge its cargo at the foot of the blast furnace, from which the heated metal starts on its journey through the plant and never cools until it emerges a steel rail—the specialty of the company, made from ore of its own mining, smelted with fuel of its own digging. The Pennsylvania Steel Company, with works on tide water at Baltimore, has ore lands conveniently situated in Cuba, and makes a specialty of bridge work and steel buildings. The Bethlehem Steel Company has ore lands in Cuba, and the leading steel maker of the South, the Tennessee Coal and Iron Company, like many others, digs its own raw materials. The financial flurry of November, 1907, enabled the United States Steel Corporation to buy the latter—a most suggestive episode."[33]

When direct control over sources of supply is not feasible other means may be used. The large refiners of oil are said to obtain very great advantages from their ownership of pipe lines. Pipe line transportation of petroleum is much cheaper than transportation by tank cars, and those companies which are large enough to own pipe lines are enabled to get their supplies directly from the wells at the lowest possible cost.[34]

[33] J. Russel Smith, *The Story of Iron and Steel* (1908), pp. 146–7.

[34] "It is remarkable that all through the discussion of Standard power and success there is no mention of a monopoly of production. The so-called anthracite-coal trust owns or controls many of the mines, and the steel corporation controls the richest of the iron-ore deposits. But the 'Oil Trust,' greater than either, strange as it may seem, has never made any concerted effort to secure general possession of the oil wells. In fact, the Standard had been thoroughly established in its monopoly of the refining business long before it entered this field of activity at all. . . .

. . . .

"The reasons for this apparently contradictory policy of struggling to dominate the refining end of the business and neglecting the sources of the crude material are clear enough, and show the wisdom of the Standard management. If it is so desired, the Standard could undoubt-

It is claimed with much show of reasonableness that the chief purpose of the packers' control of the stockyards has not been used to force prices down, or to keep out competitors through collusive buying, but to supply needed facilities for handling live stock on its arrival at market, as a means of assuring them of a continuous supply of raw materials.[35]

Summary.—It appears then, in summary, that manufacturers with their large investments in plant and equipment and with a clientele of customers whose patronage has been procured, in many cases, at great cost and after a long struggle, must be assured of an adequate supply of materials. There are four important means of insuring this supply. First, current purchases may be made in the open market. Second, contracts may be made for future delivery. Third, large supplies may be purchased in advance of actual needs. And, finally, the sources of supply may be owned or controlled.

edly acquire the same degree of control over production as it enjoys over refining and selling, but monopoly ownership of a natural resource would be likely to raise a terrific storm of the most bitter public opposition. By following its present course and posing merely as a buyer and seller of oil, with nothing to prevent the entrance of competitors into the field, the Standard points to its superior ability, efficiency, and economy as a sole basis of its success. All the time, however, it enjoys in fact a very effective control of production through its ownership of the only efficient means of transportation. The element of risk in production has also been an important factor in influencing the Standard policy. By leaving all the risks of prospecting, drilling, and operating to individual producers, the Standard runs none of the many chances of heavy loss on unprofitable ventures. When everything is considered, owning the refineries and pipe lines is far more profitable and every whit as effective as owning the wells."—W. S. Tower, *The Story of Oil* (1909), pp. 194–196. This was written before the "dissolution" of the Standard Oil "trust," but it illustrates the point just as well. See also the *Report of the Federal Trade Commission on the Price of Gasoline in 1915*.

[35] For both sides of the controversy concerning packer control of the yards see the *Report of the Federal Trade Commission on the Meat-Packing Industry*, 5 vols., and the replies of Swift and Company thereto (published by Swift and Co.).

In conclusion it should be stated that a firm need not, and usually does not, confine itself to any one method. It is often a wise policy to divide sources and to utilize various methods. In doing this the manufacturer is enabled to keep more than one source of supply open.[36] Market conditions vary from time to time and methods must be changed to correspond.

[36] This becomes particularly important with manufacturers who import from foreign countries such products as the better qualities of wool and cotton, rubber, and certain chemicals and minerals. War, a breakdown in transportation, or an unfavorable exchange, may make a particular source unavailable or unattractive.

CHAPTER VII

MARKETING MANUFACTURED PRODUCTS

I

Preceding chapters have dealt in some detail with the conditions which are peculiar to the marketing of raw materials and farm products. It is the purpose of the present chapter to point out those considerations most important to an understanding of the marketing of manufactured products.

Control of the Product.—One characteristic in particular distinguishes manufactured products from farm products: that is, the ability of the producer to control the quality of his product—to standardize products and methods of production so that it can be told in advance, within narrow limits, just what each successive product will be like. It will be remembered that some of the problems involved in marketing raw materials grow out of the lack of such standardization, and that one cause for the demand for standardized materials is the desire of the manufacturer to make a standardized product. The expensive processes of grading and of inspection are reduced to a minimum with most manufactured products, and consequently, sale by sample and by description is made easier.

Faith in the Producer.—An additional condition of importance to making easy the sale of manufactured products by sample and description is the existence of a large degree of faith in the integrity of the manufacturer. The average manufacturer, operating on a large scale, and often branding his product, has so large a stake in his good will that it is very definitely to his interest to have the run of products like the

sample or description, and like the products bearing his brand, which consumers have purchased in the past and which, because of their satisfaction, they are, from time to time, buying again. This desire to create and keep good will causes the manufacturer to wish to produce standardized goods, and the conditions of production in manufacture make it possible.

Control of Volume.—This control of the conditions of production, in addition to enabling the manufacturer to control the quality of his product, permits him to control its quantity. He can determine far in advance of actual production just what quantity he intends to produce. He can thus in large degree plan his production, marketing, and financing in advance, and he can modify the quality and change the volume of production as the needs of the market dictate.

Large Scale Production.—Large scale production is another characteristic of manufactured products which has important effects on the methods of their marketing. Some of these effects of large scale production were described in Chapter II, where the importance of demand creation to the manufacturer was discussed. They are briefly: (1) the necessity of having a large market for the individual manufacturer's product; (2) the desire for enlarging the market in order to take advantage of any economies of production or of distribution which would result from an even larger production; (3) the importance of operating the plant continuously in order to meet fixed expenses, and to keep the organization together and functioning; and, finally, (4) the fact that the development of large scale production has brought about in many industries a condition of almost constant potential overproduction.

Tendency toward Overproduction.—Whereas agriculture is predominantly a small scale industry which produces primarily staple products, manufacture is predominantly a large scale industry producing both staples and specialties, and with a constant tendency toward overproduction in individual lines. With nearly all products, whether the scale of produc-

tion be large or small, the normal situation in the manufacturers' market is a condition of keen competition with actual or potential plant capacity in excess of existing demand.[1] This situation leads to two kinds of endeavor on the part of the manufacturer: one to reduce costs of production and marketing or to improve the product or service; the other to achieve greater control over the market, by means of demand creation, the control of the supply (monopoly), or through combinations with competitors. Emphasis on cost and quality and attempts at combination or monopoly are of great importance to manufacturers of goods bought on buyers' specifications, particularly materials for further manufacture, such as cotton in the grey, pig iron, coke, and lumber. Such emphasis is also important with many kinds of equipment and supplies, including the general run of tools and machinery. Demand creation plays the larger part with new products of all kinds, with new brands of old products sold to consumers, and, in fact, with most products sold to ultimate consumers.

Need for Demand Creation.—There are among manufactured products a great number of specialties—new products to gratify old needs, and new products to meet hitherto unrealized needs and created needs. Consequently, the need for demand creation is felt keenly in a large part of the manufacturing field. With new products it is necessary to acquaint prospective customers with the product and to create a demand. As the product is unknown, exchange can take place only after the seller has done this, and the impetus

[1] It should not be inferred from this that agriculture is free from overproduction. We mean by "overproduction" that so many goods of a given kind have been produced that they cannot be sold at a price which will cover the cost of production and leave a normal rate of profit to the producer. This condition is frequently faced by large numbers of growers of farm products. Nevertheless, farmers are producing, as a rule, staple commodities having a relatively inelastic demand. Furthermore, their plant (farm) can be more readily adapted to meet changing conditions of demand.

to exchange must come from him. Furthermore, whether the products be new or old, goods sold to ultimate consumers are sold to those who are not skilled in buying and who will not, except with the larger and more important purchases, spend much time in their buying. With such customers, skillful selling effort can achieve far more than is possible when the goods are bought in large quantities by skilled buyers capable of determining characteristics and qualities for themselves.

Changing Conditions.—The desire of the manufacturer to control his ultimate market and to keep in touch with all the conditions which may affect the demand for his product has produced a rather general tendency to eliminate middlemen, or at least to take over a part, or all, of their selling function, and to control their other operations in the interest of individual manufacturers. Developments in transportation and communication have made this both more necessary and more possible of accomplishment. In this connection one of the greatest disorganizing factors in the market has been advertising: the introduction of which has taken place rapidly on a national scale, as Americans have become a national magazine and newspaper reading public. More than any other one agency advertising has enabled the manufacturer to appeal directly to consumers over the heads of middlemen, and in consequence has helped to render obsolete the established methods of distribution.

But the need for demand creation has not been alone in causing changes in the market of the manufacturer. The varying size of producing units has also had an effect. There remain many small domestic producers, and contrasted with them, and often competing with them, there have grown up giant plants, often combined with other great plants, and there are all sizes of plants and degrees of combination between these extremes. Now although it may be obviously impossible for small producers to market their product directly, it is frequently possible for the great plant with a large volume

of business and enormous financial resources to do so, or if that is not feasible it is at least possible for it to exercise a large degree of control over its distributors. And, on the other hand, whereas some small factories may be able to market their entire output in the immediate vicinity, large plants have to seek a wider market. Under such conditions many diverse methods of distribution have arisen and are found operating side by side.

Integration between Manufacturers.—The development of large scale production has led not only to direct marketing by manufacturers, but also to integration between manufacturers. In Chapter VI it was shown that plants sometimes gain control of other plants supplying important production goods. It is likewise true that, as in the steel industry and the meat packing industry, manufacturers of the cruder products have gained control of plants utilizing their output as production materials. In this way they are assured of a market and eventually they may control all the steps involved in the production of the finished products. In such cases the product of one step in the industry becomes the production material of the next. No true marketing takes place, since the two steps are under the same management. The transfer of title is largely an accounting affair, and not until the product has passed the final stage and is ready for the general market, is real sales effort or real buying effort exerted.

Wholesale Markets.—There is nothing in the marketing of manufactured products to compare with the growers' local market. In consequence, the need for physical concentration of products from such markets is missing. When sales are made the goods can usually be shipped directly from the factory without the need for an accumulation from scattered sources of great stocks at a central market. In some trades, however, there is a function which is performed by middlemen that is in some measure comparable to the work of the commission men of the agricultural market. This happens

when many of the manufacturers are operating on a relatively small scale, producing material for further manufacture —as in the textile trades—or turning out but a few of a large line of products—as in the hardware and grocery field. In these trades there are functional middlemen of exchange variously called "commission men," "selling agents," "brokers," or "manufacturer's agents," who make it their business to sell the product of a given factory to manufacturers or to other middlemen. Such middlemen are common in the textile, hardware, and grocery business.[2]

> "A most important effect of the prevalence of small scattered establishments on the method of distribution has been the resort to the broker of canned goods. The small size of the ordinary cannery has made the establishment of an expensive selling force impracticable, and the distance of the canners from the jobbers, who are located in large cities, has necessitated recourse to a brokerage or selling agency in the vicinity of the jobber."[3]

Dealers of this kind frequently contract to sell the product of several factories, and are thus enabled to sell in larger quantities than could any of the individual manufacturers they represent. It is also likely that very often the economies of marketing on a large scale are achieved in this way. The activity of these dealers is evidently somewhat similar to that of the concentrating middlemen of the agricultural market.

Although the concentrating efforts of the central market for farm products are not duplicated in the manufacturers' market, the assembly efforts of the jobbing market are paralleled. This is, of course, particularly true of products for personal consumption. But it is also true, in a considerable degree, of manufactured products—such as machine parts—which are sold to other manufacturers as production materials, as well as of equipment and supplies sold to manu-

[2] Their efforts will be more fully described in Chap. IX.

[3] *Report of the Federal Trade Commission on Canned Food: General Report and Canned Vegetables and Fruits* (1918), p. 2.

facturers, public utilities, farmers, and merchandisers.[4] Much the same considerations as were found in the wholesaling of agricultural products prevail here. The economy of shipping as near to the market as possible in carload lots tends naturally to develop dealers who specialize in purchasing large lots to break up into the smaller lots demanded by the trade. Such dealers center in larger cities because of the larger number of consumers located therein and because of the greater facilities that exist for receiving and shipping. If manufacturers prefer to sell directly to retailers or other buyers their sales branches or central offices will center at such points for these same reasons. And if buyers prefer to buy "direct" they will send their buyers to these markets, because there they will be in touch with large quantites and varieties of supplies and will benefit most from the competition of supply houses.[5]

Central Wholesale Markets.—Some cities are peculiarly well located to become great wholesale markets. They are

[4] "It is estimated that of the standard line of machine tools possibly 80 to 85 per cent is sold through dealers and the balance by manufacturers. Direct sales occur more largely in the case of new tools or devices, the manufacturer introducing the same, and then getting the dealers to stock the item. An increasing tendency toward the distribution of both mill supplies and tools through dealers is noted."—"Terms of Sale in the Principal Industries," *Federal Reserve Bulletin* (Feb., 1920), p. 155.

[5] Markets for individual commodities are often located in a particular district of a city.

"The cause for this striking segregation of the market is twofold: on the one hand it is due to unusual transportation facilities at one part of the district, and upon the other to the increasing rents at a center, driving factories to the rim and leaving the heart to offices which take up little space. These central places too offer advantages for buyers to congregate; aside from railway or hotel accommodations, it is easier for buyers to visit a series of warerooms close together than it is to travel from mill to mill, although the mills may all be in one district. Wherever an industry has become sufficiently developed in one locality to bring forth a central market for buying and selling, the advantages of the localization are greatly increased, since a well-defined place of

situated at the center of large buying areas and have superior transportation facilities. Because of their location at natural trade centers, on inland waterways or on favorable harbors at a convenient point between producing and consuming areas, they are naturally fitted to become great trading centers. With the development of railroads these natural advantages have been perpetuated; for railroads have centered there and competing among themselves and with the water transportation have brought improved transport service and low rates. Such factors were found to be determining in the location of central markets for farm products. In the case of manufacturers a further reason for the creation of such large markets is the fact that these cities have generally become large manufacturing centers. Since they serve as distributing points for certain essential raw materials, since they afford a market for finished products, and since they afford supplies of labor and capital, as well as adequate transport, they become large manufacturing centers. These cities serve, consequently, not only as assembling points for products from distant factories, but also as dispersing points for products manufactured in the surrounding district.

New York is thought of primarily as a commercial city. Its harbor and its means of reaching an important hinterland by rail and water have developed it into an important import and export market for manufacturers as well as for raw materials and foods. But New York is the greatest manufacturing center in the country. Chicago is not only an important central market for farm products, but also a great center for wholesaling finished products of all kinds, and a leading manufacturing center. St. Louis, with adequate transport facilities to the vast agricultural districts to the west and south, early became the greatest distributing center in the country for hardware products. Kansas City in a

bargain and sale secures more trade than would a number of scattered offices."—Malcolm Keir, *Manufacturing Industries in America* (1920), p. 78.

similar location became the foremost distributing point for agricultural implements and machinery.

But though our largest cities are the great central distributing points for manufacturers, they have gradually lost their relative importance. With the growth in the density of population and with the gradual westward movement of population and of manufacture, markets have developed in many smaller cities to serve as local distributing points for the supply of surrounding areas.

The Sale of Manufactures.—Competition among manufacturers is different and the market is not so well unified as is the market for farm products. With the latter, competition often works itself out in organized exchanges, and to a less degree, through auction companies. But the manufacturers' market for few products is so unified. There are practically no exchanges. Buying and selling of products at wholesale tends to center in the wholesale markets which have been described, but purchases and sales are made as the result of private bargaining rather than through open trading on exchanges or auctions. No rules are laid down by a central body, as in the case of the organized exchanges, and there are no centralized offerings through a single medium as with the auction company. Rather, there exist in the central markets the offices of manufacturers, wholesalers, and brokers, to which buyers come, and from which the sales efforts of vendors radiate.

Neither is the sale of manufactured goods closely confined to a price basis. But here one must generalize with care. Semi-manufactured goods in particular are likely to be sold on a price basis, resting on sellers' grades or buyers' specifications. But the characteristics of the great bulk of consumers' goods cannot be readily determined or standardized, and individual consumers and classes of consumers react in different ways to the same characteristics. Consequently, more selling and shopping is found in their sale. Even when actual resale prices are fixed, as with certain products ad-

vertised to consumers, such as Victrolas, Kodaks, and Arrow collars, bargaining is really carried on through the use of advertising and salesmen. For an endeavor is made to convince consumers or dealers that they will get the most for their money if they purchase a particular product.

II

Classes of Manufactured Goods.—The problems involved in marketing manufactured products differ with the purposes for which they are used and the type of market for which they are produced. There are: three important classes of manufactured goods which closely correspond to those described in Chapter I. These are: (1) semi-manufactured products which must be further processed before they are ready for their final market; (2) equipment and supplies for factories, mercantile establishments, and such service institutions as banks and public utilities; (3) finished products ready for final consumption by industries and institutions, or for personal consumption by individuals.

Semi-manufactured Products.—Semi-manufactured products are production materials for other factories, and as such their marketing bears a close resemblance to the marketing of raw materials discussed in Chapter VI. A chief problem with these goods is not only to manufacture a product of a particular determinable quality, which will meet the requirements and specifications of the market, but also to make this product at a cost which is low enough to enable the producer to compete on a price basis and still net a profit. It is further necessary to give good service to customers. Here, as with raw materials, the need of the customer to be assured of a product of uniform quality supplied as he requires it assumes large importance. The ability of an individual manufacturer to meet this need, and the fact that he does, are important considerations in procuring and maintaining patronage. Again, as with raw materials, so here, factories

depending upon such manufacturers for their materials frequently find it to their advantage to own and operate, to control, or to have close business relations with such supplying industries in order that a continuous supply may be assured. Consequently, in such industries there is frequently a large degree of integration of manufacturing steps.

The problems of marketing these production goods are relatively simple. Little or no demand can be created other than through the rendering of good service and the ability to offer lower prices than competitors. The chief problems are, consequently, problems of production and not of selling. Nevertheless, these very facts may make it desirable for the producers of these goods to control the further processes of their industry in order to insure themselves a permanent market. Integration, then, may result either from the desire of the buying industry to be assured of a supply or from the desire of the selling industry to be assured of a market. Little demand can be created because the goods are usually bought on specification, and on delivery they are sampled in order to determine whether they conform thereto. That is, the buyer decides for himself the characteristics of the product. He does not need to be told.

Another important characteristic of semi-manufactured goods is the fact that they are usually bought on a large scale by a relatively small number of buyers. The difficulties, consequently, in finding the possible buyers and the problems of splitting large lots into suitable quantities are not great. The marketing machinery is simple.

Equipment and Supplies.—Equipment and supplies, such as machinery, oils, paper, cloth, and office equipment, which are bought for use in industry and commerce, have some of the characteristics of semi-manufactured products and some of those of finished products for personal consumption. With them, measurable physical characteristics are important, and to the extent that these predominate demand creation is unimportant and cost and service are the important considera-

tions. But the mere physical characteristics of the materials from which the product is made are often of less importance than the performance of the article in use. Here there is frequently less opportunity to test out the article with any great degree of accuracy, except as it is tested out in operation over a period of time. Future performance is hard to determine in advance and opinions may well differ on the importance of particular effects and on the manner in which different products produce them. These conditions leave room for sales effort.

With heavy machinery the weight and strength of a heavy and expensive frame must be balanced against a lighter, less expensive frame, but one which may, nevertheless, outlast the demand for the machine. Particularly in industries in which processes are changing rapidly must such characteristics be balanced. There may not even be agreement on just how heavy or of just what materials a particular machine or its parts must be made in order to stand the strain of everyday use. Machines may be built, furthermore, to utilize varying degrees of labor in the performance of the same mechanical operation. Here are opportunities for convincing sales effort on the part of competing manufacturers. Office furniture and equipment may be of oak or mahogany, with light and dark finishes; they may be of steel or wood, light or heavy in structure. There are also constant innovations in the nature of specialties. It has required the greatest of sales efforts to get business men to install typewriters, adding machines, and telephones; demand has had to be created. Often, too, equipment is bought only occasionally or in small quantities, and, consequently, the care and time may not be used in the effort to get the lowest price for a particular quality that it pays to take with the larger or more frequent purchases. With all such products, then, in varying degrees, the manufacturer must sell on a basis of price and service. But he may also need to utilize definite efforts to sell the quality and characteristics of his product.

Consumption Goods.—The greatest marketing problems are found with finished goods for personal consumption. These are manufactured for sale to the ultimate consumer who usually buys in small quantities. He is not skilled in purchasing, and consequently, must depend to a large degree on the word of the one from whom he buys.[6] Here, then, is a great opportunity for demand creation. Since the ultimate consumer buys a great many different kinds of merchandise in small quantities, it does not pay him to spend any great amount of time in examining the less important qualities of competing products, and he never becomes a skilled buyer or a careful buyer in the same sense as do the purchasers of production materials, equipment and supplies. Furthermore, goods intended for personal consumption satisfy intangible desires and their characteristics are not usually subjected to close examination and measurement. The same physical characteristics appeal to different individuals differently, and to the same individual they may make differing appeals at different times and under different circumstances. Finally, it is in the field of personal consumption that so many new products, to gratify new and often, to the consumer, unknown needs, are found—as well as new or changed products to meet well known wants. In such cases the consumer must be told of the product; demand must be created.

Price and Service.—Price, too, is important. But it is of far less relative importance than in the sale of the other classes of goods. And as between consumer goods it plays a greater part with some than with others. It is more important, for example, in the competitive sale of sugar and flour than it is in the competitive sale of furniture or clothing.

Service is particularly important, and is manifested in a variety of ways.[7] It is, in fact, as far as the purchaser is con-

[6] That is, he must do this until he has thoroughly tried an article himself.

[7] In so far as it relates to selling the final consumer, service will be discussed in the chapters on retailing. In so far as it is of importance with

cerned, a part of the product, a part of the thing which he is purchasing. But as it is not physically a part, it is usually considered a separate item. Indeed, the product and the service rendered in connection with its sale may have to be considered separate elements in determining its exchange, and each be paid for separately.

Production for the Market.—The fact that consumers buy a large variety of products in small quantities, many of them at frequent intervals and without previous notice to the supplier, still further complicates the distribution of consumption goods. Large amounts have to be split into smaller quantities, sometimes at two or more stages in their merchandising. This occurs when staple products, such as groceries, drugs, hardware, and dry goods are sent in large quantities to wholesale distributors, and then are divided into smaller lots which are sent to retail distributors, who finally divide them into the small amounts in which they are purchased by the final consumer.

Because the final consumer does not determine on his purchases very far in advance such goods are said to be "produced for the market," that is, they are produced in advance of actual consumer demand. This fundamental situation is not altered when the manufacturer sells on contracts made in advance of production, for the goods are then held for the market by the wholesale and retail dealers. There is, consequently, a large element of market risk in merchandising consumer goods. Even the manufacturer who contracts with the wholesaler in advance of production, and the wholesaler who contracts with the retailer in advance of the "season," are not thereby entirely freed from this risk. For if the final consumer does not buy in the quantities and at the prices anticipated, contracts may be cancelled or retail buyers may be unable to meet their obligations.

Selling Consumption Goods.—Semi-manufactured products

the manufacturers who sell consumer goods through middlemen, it will be discussed in the chapters immediately following.

and equipment and supplies are exchanged in large units and the sale is frequently consummated directly, or with the assistance of a broker. They are also sometimes handled by wholesale merchants. But finished products for personal consumption are almost uniformly purchased from retail dealers. The manufacturer's immediate selling problem, therefore, is one of selling the retail dealer. Although, as will be shown later, it may in the end prove to be a double problem—i.e., of creating a demand for the product on the part both of the consumer and of the retailer—if the manufacturer is to succeed. But that demand will still, usually, be felt by the manufacturer through the retail store.

In selling to the retailer the manufacturer has the choice of selling to him directly or of utilizing some of the market intermediaries who act as middlemen between manufacturer and retailer. The most important of these are jobbers. But functional middlemen of exchange, such as brokers and commission men, who operate between manufacturers and jobbers or large retail organizations, are also important.

III

Division of Market Work.—There are three basic methods of demand creation: (1) personal solicitation (salesmen), (2) the use of symbols (advertising and correspondence), (3) and samples —either the product in actual use, or samples carried by salesmen. These methods may be used by the manufacturer and, in addition to using these, he may depend upon the assistance of middlemen.

The manufacturer may create a demand for his product with his own efforts,[8] or he may depend upon middlemen to create this market for him. He may also depend in part upon his own efforts and in part upon the efforts of mid-

[8] This is sometimes called "direct selling." Sale by manufacturers directly to retailers without the use of intervening middlemen is also sometimes called "direct selling."

dlemen; utilizing a combination of his own agencies with those of the middleman. He may, in other words, coöperate with the dealers who sell his product and depend upon this combination of efforts to sell his goods.[9] Practically all manufacturers utilize the retailer in the sale of goods for personal consumption, although there are important exceptions, such as the sale of many household utilities, books, and typewriters.

With the problems of physical supply, finance, and risk the manufacturer has the assistance of the basic service industries involved: transportation systems, storage plants, banks, insurance companies. But further than this, other special facilities may have to be supplied. And in his coöperation with these basic service industries he may act alone or he may act with, or through, the same middlemen that are involved in creating a demand for his product. Some of these activities may also be carried on by the final purchaser, rather than by the producer or the dealer. In the sale of most staple products and of many specialties the middlemen of the wholesale market are so important in placing the product in the hands of the retail dealer, that the utilization of such agents is often spoken of as the "orthodox" method of distribution, and any departures from it are considered "irregular."

Channels of Distribution.—The most common channels of distribution for manufactured products ready for personal consumption are:

(1) Sale to consumers
(2) Sale to retail stores
(3) Sale to jobbers, who sell to the retail stores
(4) Sale through functional middlemen of exchange, who sell to the jobbers, who sell to the retail stores.

[9] See Paul Wesley Ivey, "The Manufacturer's Marketing Problem," *Administration*, Vol. I, No. 3 (Mar., 1921), pp. 341-47.

1. *Sale to consumers.*—The direct sale of products from manufacturer to consumer is the most obvious, and from some points of view the simplest, method of distribution. The cabinet maker and the custom tailor usually produce on order for the ultimate consumer. But this channel of distribution is by no means confined to the custom trade. The products of many large manufacturing organizations are frequently sold directly to the consumer, as some typewriters, books, and kitchen utensils.

Three general means for making sales directly by the manufacturer to the consumer are in use: (1) advertising (the ordinary "mail order" method), (2) salesmen, and (3) retail stores owned by the manufacturer. The first method depends entirely upon advertising and correspondence to make its selling appeal, and physical distribution is made through the usual channels as convenience or necessity dictates, although it may be necessary for the manufacturer to extend credit and to furnish his own warehousing facilities. Many firms do a part of their selling in this way. Some middlemen also utilize this method. Thus jobbing houses which depend upon salesmen to keep their trade and to introduce new products likewise encourage customers to order from them by mail, and some jobbers, such as Butler Brothers and the Baltimore Bargain House, depend primarily on this method. As a method of sale the distinguishing characteristic of mail order selling is the use of some medium of communication other than personal solicitation and personal contact with the product. Obviously, the basic methods of physical distribution will have to be used, although such facilities as are normally furnished by middlemen may have to be provided by the manufacturer.

The second method of direct sale is by the use of salesmen compensated for their services by the manufacturer. In this case sales are made through personal visitation by the manufacturer's representative. The salesmen may, of course,

perform other functions than selling, such as demonstrating the product on its delivery, adjusting difficulties, collecting accounts; but their primary work is to sell. Certain cooking utensils, as well as cash registers, and most typewriters are sold in this way, and very many, perhaps the majority of manufactured goods sold to other manufacturers, as materials or as equipment or supplies, are sold by salesmen. Wherever the size of the normal order and the margin of profit are great enough to warrant the time and expense involved in such solicitation, there is usually a strong preference for this particular kind of direct sale.[10]

Finally, the manufacturer may own his own retail stores. Through them he comes into direct contact with his customers and retails his products to them just as is done in any retail store. Some brands of tobacco products, and some brands of shoes and of clothing are sold in this manner. In so far as bakeshops make their own products, or candy stores their own sweets, this direct method of distribution is practiced. It is by no means usual for a manufacturer to depend entirely on his own stores for his market. His retail stores frequently serve as an experimental means of contact with the consumer, or as an assured market for part of the output, the great bulk of the product being retailed through independent stores.

2. *Sale to retail stores.*—The addition of a single intermediary, the retailer, who buys the product of the manufacturer and in turn sells it to the consumer, is the distinguishing characteristic of what is sometimes called the manufacturer-retailer-consumer channel of distribution. Although the manufacturer may endeavor to create a consumer demand for his product through salesmen or advertising, the actual sale is here consummated at the retail store. Shoes, men's clothing, and hats are familiar examples of products which are often sold in this manner. Certain large producers of cookies,

[10] See Chap. VIII, on the use of the jobber, and Chap. X, on the conditions favoring direct marketing.

crackers, cakes, confectionery, soaps, and pickles also sell directly to retailers.

3. Sale to jobbers.—The addition of a second middleman, the jobber, who buys of the manufacturer and sells to the retailer, forms what is known as the manufacturer-jobber-retailer-consumer channel of distribution. It is used by probably the larger number of factories producing standardized goods for the ultimate consumer. Such staples as groceries, hardware, drugs, and dry goods are usually sold in this manner. For such it is often called the "orthodox," "regular," or "normal" channel of distribution. This system, unmodified, would mean that the manufacturer would sell to the jobber and that there his control and immediate interest in his product would end; the jobber would sell the next in line, the retailer, and there his control and immediate interest would end; finally, the sale by the retailer to the consumer would complete the distribution of the product. But more and more manufacturers follow their products through all of the steps enumerated, watch carefully the conditions surrounding their sale, and frequently assist from point to point.

By means of advertising and salesmen many manufacturers who sell to jobbers are now exerting considerable influence upon the sale of their product at each point in the channel of distribution where a change of ownership takes place. Through so-called "national" advertising in magazines and by means of bill boards, electric signs, newspapers, and by circulars and direct letters, they endeavor to create a consumer demand. Through advertising and personal salesmanship they endeavor to sell jobbers and retailers. They also try to influence the dealers in their favor by assisting them in their efforts to sell the consumer. Their efforts to sell the consumer assist the retailers to make sales to consumers and the jobbers to sell retailers. And through this means and their other efforts they induce the dealers to supplement these efforts; the retailers, by selling the consumers, and the jobbers,

by selling the retailers. There is thus established a degree of coöperation which is, if successful, of mutual benefit to manufacturer and middleman.

4. Sale through functional middlemen.—A fourth channel of distribution includes another middleman, the selling house, which represents the manufacturer. Such a middleman commonly takes charge of the sale of the manufacturer's product, selling to the jobber or retailer or to other manufacturers. For goods intended for the ultimate consumer this usually means the addition of another distributor between the manufacturer and the jobber—a distributor, however, who usually does not own the product he sells, but who handles it on a commission basis for the manufacturer. The channel of distribution then becomes manufacturer - selling - agent - jobber - retailer - consumer.[11] Many textiles, groceries, and hardware products are sold in this way.

In a few trades, notably the textile trade, there are middlemen who represent manufacturers in the purchase of the raw materials and manufactured products which they use in their own factories. When these dealers are buying manufactured products, as cotton in the grey or yarn, they may purchase directly from the manufacturer, or, in case the latter utilizes the services of a selling agent, they may purchase through the selling agent; and then both parties to the final sale are represented by a middleman. Wholesalers who merchandise many products sometimes buy through such middlemen, and importers of manufactured products also utilize their services.

Middlemen Perform Other Services.—The great service of middlemen to most manufacturers is the effort they devote to selling goods. But they are important for other reasons, and, although many manufacturers attend to their own selling, it must not be assumed that the services of the middlemen are thereby entirely eliminated. In fact the efforts of

[11] See Chap. VIII, also L. D. H. Weld, "Marketing Agencies between Manufacturer and Jobber," *Quarterly Journal of Economics*, Vol. XXXI, pp. 571–599.

middlemen are seldom confined to demand creation. They often perform an important part in financing, in physical distribution, and in the assumption of risks. The selling agent of the manufacturer may merely make sales, but frequently he guarantees the accounts of the firms to whom he sells and attends to the collections. The jobber usually sells the product and attends to its physical distribution, assumes risk, and assists in financing; but for many manufacturers he performs only one of these functions or even a part of one. Sometimes the jobber merely makes the sale and sends the order to the manufacturer, who attends to the delivery of the goods, looking to the jobber, perhaps, for payment. On the other hand, some manufacturers sell their own product but send the order through the jobber, who attends to the physical distribution, assumes the risk, and collects the accounts. Some manufacturers send out specialty salesmen, who drum up trade for their product in addition to that procured by the salesmen of the regular dealers through whom it is handled. Some advertise their product to consumers and to retailers, although the final sales to the consumer are made and distribution is attended to by jobber and retailer.

Combination of Channels is Common.—Not only do manufacturers utilize the services of middlemen in varying degree, but the same manufacturer may use more than one channel of distribution for his goods. One cause for this arises out of the different markets in which he may be selling. In selling a national market, such as that in the United States, the manufacturer is really selling in a number of different kinds of markets. He is selling in large cities, in small cities, and in the country. In the large city he may decide it will pay to own his own retail stores, or at least to do his own jobbing; in smaller cities he may find it best to use the "regular" channel of distribution through jobber and retailer. Again, in a single city his market may vary from the kiosk in the foreign section to great department stores and exclusive specialty shops. Some department stores buy in larger quantities than

do many jobbers, and by reason of this they are often able to buy at the same prices as the jobber, or even lower than he. Many manufacturers sell to any dealer who will buy, varying prices according to the quantity purchased rather than according to the kind of dealer or consumer. A manufacturer may be selling directly to the department stores, whereas other business houses in the same city make their purchases only through the jobber.

In different sections of the country and with different kinds of trade, the hold of the jobber on the retailer varies in strength. Such local preference will also affect methods. In sparsely settled regions the manufacturer may decide that he can get more sales per unit of expense through the mail order method, or through the jobber; in dense areas he may do his own jobbing or even his own retailing; and he may experiment in one market with a new plan of sale while continuing with the tried and sure methods in the remainder. Finally, different methods are often used in the foreign market from those used at home, and a manufacturer who has built up a strong trade through dealing directly with the domestic retailer or consumer may find it advisable to utilize middlemen in a part or all of his foreign trade.

CHAPTER VIII

WHOLESALE MIDDLEMEN OF THE MANUFACTURER'S MARKET: THE JOBBER

To know the functions performed by middlemen one must turn to the functions involved in marketing,[1] for all of these can be, and are, performed by middlemen. As in the agricultural market, so in the manufacturers' market, there are middlemen who perform all of these functions, and there are agencies highly specialized in the performance of one function or of a part of one. Examples of the latter are such specialized agencies as bankers, insurance companies, and advertising agencies, who perform their particular function in the marketing of many kinds of products, both manufactured and agricultural. Examples of the former are the familiar jobber and retailer.

The Jobber.[2]—The chief service of the jobber in marketing manufactured goods is to supply the retailer with merchandise. He purchases goods in large quantities, and usually in wide variety, divides them into smaller quantities and sells them to his customers, the retail merchants. His work is to *assemble* for the convenience of the retailer the products the latter supplies to the consumer. From the point of view of the manufacturer whose product he handles, the jobber's func-

[1] See Chap. II.

[2] Historically the jobber and wholesaler of manufactured goods seem to have been distinct middlemen, but gradually their functions have been merged until today the terms are used synonymously in practically all trades. Where a distinction is made, the term "wholesaler" is likely to be applied to those operating on a large scale and covering a wide territory. Thus, the trade speaks of "wholesale grocers" and of "grocery jobbers"—the latter operating on a smaller scale.

tion is to *disperse* manufactured products. But that is incidental to, and a necessary accompaniment of, his chief office —to assemble the products which the retailer wants; to divide them into the proper sizes, qualities, and varieties; to see to it that they reach the merchant as needed; and often, through granting credit, to assist the retailer in financing his business.

The Jobber's Service to the Retailer.—(1) The greatest service performed by retail merchants for consumers is to bring together at convenient places the products which the consumer is in the habit of demanding on short notice. In the marketing of staple products, however, this work of assembling is to a large extent performed by jobbers. It is often a difficult task to collect the various commodities which consumers demand. There are hundreds of manufacturers producing articles for grocery, hardware, dry goods, and drug stores. To receive the salesmen of such firms, to answer their letters, or to pay close attention to their selling activities, is impossible for any but the largest retail stores. The cost of buying would prove to be too great a burden for the smaller stores. But the jobber makes it his business to keep in touch with sources of supply, and, buying goods to be sold through many stores, he is enabled to purchase in large quantities and so to reduce the unit cost of assembly. This service is particularly important when many different products are handled in a single concern. In case the establishment handles but a few lines and the products of a few manufacturers, as does the shoe store, the men's clothing store, the automobile agency, it becomes possible for the retailer to do business directly with the manufacturers, and consequently middlemen are less used. This is the case because purchases are few and the quantities involved are large. But even in such lines, on account of other advantages, the jobber is often utilized to some extent.

(2) The division of large amounts into smaller is ~~an important service~~. Manufacturers find it advantageous to sell in large quantities and the inducements which they offer in

the form of quantity discounts and free deals often make it unwise for small stores to buy directly. It is, furthermore, often impossible to buy directly, since some manufacturers will not sell to retailers, particularly small ones. Again, large shipments are more economically handled than small, and freight rates favor quantity shipments, so that the nearer the product can be moved to the ultimate consumer in large lots the more economically it can be distributed. This renders such a service indispensable and so opens the way to the jobber—for the function of dividing these large stocks into the smaller quantities which retailers buy is commonly performed most economically by an agency between producer and retailer. Finally, since the labor of assembling is most economically performed by a specialist—the jobber—working on a large scale, it follows that he is often the logical medium for grading and dividing and arranging the goods into the qualities, quantities, and groups the retail dealers desire.

(3) Another important function which the jobber performs for the retailer is the granting of credit. Many retailers would be unable to begin or continue their business if they had to pay cash for all the goods they buy. This makes an entering wedge for the jobber. If he has sufficient funds, or can get credit, he is enabled to carry the retailer until the latter has sold a sufficient quantity of the goods to be able to make payment.[3] In fact, some retailers are kept in business in this way; and it might well be said of many such arrangements that the retail stores serve as outlets for the jobbers' products and, through this granting of credit, become mere agencies for the sale of the jobbers' product.

(4) As a specialist in distribution, the jobber can give other valuable assistance to the retailer. By watching the

[3] There was a tendency for manufacturers and jobbers to shorten credit periods and to demand cash during the World War, but it does not seem to have continued to the degree it had been hoped. In fact, the slow movement of products in recent months has in some cases forced the lengthening of credits.

market with care he can advise as to what goods are likely to sell best, and in what quantities; he can also advise when to drop certain lines which are likely to lose in public favor.[4] In touch, as the jobber's salesmen are, with hundreds of retail stores and with the market in general, either individually or through the house, they are able to give the retailer many valuable suggestions which an intelligent merchant can use advantageously.

(5) Again, if the retailer did not buy from the jobber he would undoubtedly be in need of much larger storage facilities and would need larger financial resources than he usually possesses. Orders to manufacturers must often be placed far in advance of delivery and for relatively large quantities, frequently involving more goods than the retailer can use in months. To buy in this way would necessitate large warehousing facilities, in addition to large financial resources, and would force the retailer to bear the market risks—the risk of falling prices, the style risk, and the risks of physical deterioration involved in holding goods for a long time in large amounts. But when the retailer purchases from the jobber he can buy small quantities at frequent intervals and the jobber bears the brunt of these risks and cares for the financing and storing. By thus allowing retailers to order in small amounts, the jobber assists them to increase the rapidity of their stock-turns, and thereby makes possible the more economical operation of the large number of small retail stores which modern consumers demand.[5] Most manufacturers find

[4] See A. W. Shaw Co., *How to Run a Wholesale Business at a Profit,* pp. 219–220.

[5] By the same token, however, the jobber's stock-turn is thereby lowered, particularly if he grants credit. But it seems evident that the total reserve stock necessary to supply the trade of say, fifty small retailers would be less if held in one central warehouse (the jobber's) near the stores, than if each store tried to carry sufficient stock to meet the variations in its trade. This is true because the variations in day to day demand would be relatively less for the trade of fifty stores, with

it too expensive to handle the small orders of the average store, and are not able to make quick deliveries of small orders, nor are they willing to grant credit to so many customers; indeed, frequently, they have not the financial resources to do so. The jobber performs, then, this important service of carrying reserve stocks upon which the retailer can draw from day to day or week to week as his trade demands.

Summary.—From what has been said it appears that the chief service of the jobber to retail dealers is to assemble the products they demand—to get these products to them promptly in the proper qualities and quantities, to advise them concerning market tendencies and merchandising policies, to finance them to a large extent in their selling operations, and to relieve them of the storage costs and the burden of bearing the risk which would be involved in the direct performance of these functions.

The Jobber's Service to the Manufacturer.—Whereas the jobber aids the retailer in assembling products, he serves the manufacturer in dispersing products to retail dealers. (1) The jobber ordinarily buys merchandise outright, and takes upon himself the problem of selling it to the retail trade, as well as some of the market risks and storage costs the manufacturer would otherwise bear. Instead of attempting direct sales to the retail trade the manufacturers who sell to the jobber virtually turn over to him the problem of selling the retailer. And the jobber sometimes affords an excellent channel of distribution for the manufacturer: one which is highly specialized for dealing in a definite field, with a developed selling organization, an existing clientele, and a knowledge of the prospective market. These advantages are likely to prove of inestimable value to the manufacturer, and to offer

reserve stocks in the jobber's warehouse, than for each store carrying its own reserves. In addition, the jobber's business is large enough to cause the manufacturer to give him good service, and so he can get fast deliveries on short notice.

a selling service which he could not duplicate for anything like the margin between the price received from the jobber and the price which the jobber receives from the retail dealer.

Handling many products as he usually does, the jobber can work a given market more intensively than can most manufacturers. In an out of the way territory or in selling to small merchants the jobber can make a worth while profit, whereas the manufacturer of a single product would find the selling costs prohibitive. The jobber would sell many different articles; so the total bill would be large, and the costs, consequently, would be spread over a larger order. Thus, in the hardware business thousands of articles are listed in some of the larger jobber catalogues and many varieties of a given type are shown.[6] For the manufacturers of most of these articles to approach each retailer would involve not only a prohibitive cost to the manufacturer, but would be an inexcusable social waste. Only manufacturers who are producing a wide variety of goods, such as Heinz's "57 varieties" or the National Biscuit Company's products, or manufacturers of a single product of large value, such as typewriters, or of merchandise bought in large volume by retailers, such as shoes, clothing, meats, can approach the jobber in the economy of their distribution costs.

(2) Again, as has been noted, the jobber performs valuable

[6] Inquiry among several Chicago jobbers elicited the following facts concerning the number of products handled; although many of the articles listed are not kept in stock by the jobber, being obtained from the manufacturer as needed. A large hardware company handled over 50,000 items, including all sizes and varieties of each product. Ignoring sizes, over 30,000 items are handled. Among the items listed in their catalogue were 51 different paints and varnishes, 24 stoves and ranges, 34 articles in saddlery, 36 agricultural tools—and each of these in several sizes. A drug jobber, handling 4,500 different items, lists 1,520 drugs, 85 candies, 60 cigars. A jewelry jobber keeps in stock 460 different makes of watches, 258 makes of diamond rings, 190 neckchains, and 106 makes of bar pins. A paper jobber carries among other things 286 brands of bond papers, 264 flat papers, 93 ledger papers, 36 linen papers —each in 40 different sizes.

services in regard to transportation and storage. A few large shipments to jobbers take the place of hundreds of smaller shipments to retail stores and are made throughout at a lower cost. The jobber stores these products at convenient points until they are wanted by the retail trade. As he handles many products which are constantly coming and going a given storage space will perform more service for him than it would for either the manufacturer or the retailer; and he can afford a better storage organization because administrative expenses will be less. By delivering numerous articles, rather than a single article as would the average manufacturer, he greatly reduces the unit cost of delivery.

(3) Just as the jobber gives valuable financial assistance to the retailer, so in some instances he assists the manufacturer. This assistance ranges from direct loans, such as are sometimes made to the canners of fruits and vegetables, to the indirect service performed in carrying the accounts of retail merchants, which, if the jobber were eliminated, would have to be carried by the manufacturer himself if existing credit terms continued. The jobber frequently contracts to take the manufacturer's product before the latter begins to produce; and he sometimes advances funds to him, and often pays cash for his product, although in a growing number of cases the jobber is given credit by the manufacturer.[7] His financing function thus assumes large importance. On the one hand, he may be giving credit to the retail dealers, and on the other, he may be buying on shorter terms than those he grants, or for cash, and he may even advance funds to the manufacturer.

(4) The existence of the jobber also simplifies the manufacturer's credit problem. Manufacturers who sell directly to retailers may have to carry on their books the names of thousands of retailers[8] and to keep in constant contact with

[7] See pp. 336–341.

[8] Mr. Parlin estimated in 1915 that there were not far from 300,000 grocery and general stores handling groceries plus 100,000 other retail

all available sources of retail credit information. The jobber takes this work from their shoulders, which leaves simply the need to obtain credit information concerning a few jobbing houses that are usually large enough to have their rating easily ascertained.

Going "Around" the Jobber.—By no means all manufacturers, even of staple lines, utilize the services of the jobber and many use them only in part. The combinations of direct marketing with marketing through the jobber are various, and the number of manufacturers who do this and of those who do not use the jobber at all seems to be growing.[9] Some manufacturers do their own selling, through advertising, salesmen, and correspondence, but have orders sent through the jobber who carries the goods, collects the accounts, accepts repeat orders, and performs other functions. In other cases the jobber continues to sell the product, but through the means of drop shipments[10] part of the work of physical distribution is shifted to the manufacturer. When jobbers sell goods in carload lots, the carload is frequently shipped directly from the factory; but it is not usually economical to send smaller shipments in this way. The business relations in such cases vary with the nature of the services performed, the relative power of the manufacturer and jobber, the status of competition, and the nature of the market.[11]

It thus appears that the work of the jobber is not always the same, and that the distribution of functions between manufacturer and jobber varies greatly. In the last analysis, the extent to which the jobber is used by a manufacturer is determined in part by the relative cost of different methods,

outlets handling foods. See C. C. Parlin, *An Address Delivered before the District Sales Managers of the Joseph Campbell Company* (Dec. 28, 1915), p. 1. (Pub. by The Curtis Publishing Company).

[9] See L. D. H. Weld, "The Economics of Advertising," *Printers' Ink*, July 11, 1918, pp. 4–6.

[10] This is a shipment made directly from the factory, when the sale has been made by the jobber, or vice versa.

[11] See pp. 172 ff. and Chap. XXI.

in part by the financial resources of the parties involved, and in part by the personal ability of the business men. That is, under fundamentally similar conditions of cost, the financial resources and the ability of the manufacturer as a merchandiser often determine the extent to which he will utilize his own efforts rather than depend on those of the jobber. Where one man would boldly launch a direct marketing campaign, and succeed, a second would launch forth as boldly, and fail, and a third having less imagination and initiative, or less confidence in his own merchandising ability, would not even make the attempt. This matter of the personal equation of the business man is of the utmost importance in determining and in explaining the merchandising methods of individual firms, and is a frequent cause for finding widely divergent methods used in marketing similar products under apparently similar conditions.

Jobbing Lowers Costs.—Despite these personal variations the fundamental fact of cost, with its various modifying influences, remains the most important consideration. The economic justification for jobbing is the fact that it lowers the cost of distribution. Where the service to be rendered in distributing a given product from producer to retailer can be most economically performed by the jobber, he is likely to be used. It is obvious then, that the service to be performed is fundamental to any determination of the conditions which make the use of the jobber essential.[12]

Jobbers "Eliminate" Manufacturers.—Just as the manufacturer is going into the field of the jobber, so the jobber is going into the field of manufacture, and there are today manufacturing-jobbers as well as manufacturers who do their own jobbing. The manufacturing-jobber is one who puts out under his own brand or under one which is identified with his name, a large part of the products which he handles. He may manufacture them himself, as is done with Lyon and Healy

[12] The discussion of these conditions has simply been introduced in this chapter. They are enlarged upon in Chaps. X and XIV.

pianos; he may subsidize manufacturing plants which produce them—even buying the entire output of certain plants—which is done sometimes with canned foods; or he may simply attach his own brand to goods bought in the open market as wholesale grocers sometimes do. But regardless of his relation to manufacturers the product is identified with his name rather than with theirs. This intrusion upon the manufacturing field by the jobber, and the invasion of the jobbing field by the manufacturer, are among the tendencies of greatest importance in marketing manufactured products. And the general tendency has gone even further. Both of these have entered the retail field, and retailers in their turn have gone into wholesaling and manufacture. This tendency has come about because of the intense competition for sales, and, in turn, it has made that competition more intense.

Private Brands.—One result of the intense competition for sales has been the introduction of private brands by manufacturers, jobbers, and retailers. By branding the products which he merchandises, the business man helps to retain any good will which his aggressive sales efforts have created.[13] The introduction of aggressive selling by manufacturers and the fact that both manufacturers and jobbers brand many of the products which they merchandise sometimes gives rise to ill feeling. Some of the reasons for the introduction of jobber brands will be given at this point.[14]

(1) Jobbers sometimes believe that manufacturers who brand their products and assist in selling them to retailers and consumers, take advantage of the control they are able to exercise in the market, by reason of the good will they create, to cut down the profit made by the jobber on the sale of these goods to such a point that he makes nothing from handling them. In order to fight this situation, as well as to gain the same kind of good will for their own wares, many

[13] See Paul T. Cherington, *Elements of Marketing*, Chap. XIV. The question of brands will be discussed further in Chap. XIX.

[14] The manufacturer's position is discussed in Chap. X.

jobbers have established their own brands. The truth behind this situation is not always evident. For the manufacturer, on the other hand, claims that through performing the function of demand creation himself he has taken away one of the greatest expenses which the jobber's margin formerly covered. For performing the function, he is entitled to the part of that margin which covered that expense under the old system. Apparently this is a question of fact. If the manufacturer does create the demand, he surely should no longer pay the jobber for doing it. Whether he takes advantage of his power in the market to exact even more than this cannot be readily ascertained in most cases. Although it seems improbable that many manufacturers have created a consumer demand strong enough to overcome the antagonism which such a price policy would involve, the fact that a few have done so makes the jobber suspicious of all similar selling efforts. If the dealer thinks the manufacturer is allowing too small a margin, or if he fears that the margin will ultimately be cut, it gives rise to as much ill will in the relations between them as though it were the actual fact.[15]

(2) In other cases, the jobber fears that after he has spent time and money in building up a demand for the manufacturer's product, the manufacturer will decide to sell to retailers himself, or to sell to some other jobber. Since the product is branded, he would lose the demand for it, even though he had borne the cost of creating that demand. The effort spent, if it had been applied to a product bearing the jobber's own brand, would have brought permanent trade and good will. To protect against this possibility, the jobber may introduce a competing brand of his own, and thus cause ill feeling on the manufacturer's part, and perhaps hasten the severance of business relations. Even though the jobber has expended little or no time and money in demand creation, the loss in good will when a branded product is taken from him has still

[15] Cherington lays the private brand "problem" largely at the door of "concentrated" retailers. See his *Elements of Marketing,* pp. 151–5.

to be faced. For although the manufacturer may have taken the entire burden of creating the demand, when he takes the product away from the jobber he leaves, thereby, a hole in the jobber's sales which may prove difficult to fill. Finally, the whole tendency toward "direct" marketing is against the jobber's fundamental interest. If enough producers do this, there will remain no need for the jobber's service.

(3) Another important reason which, undoubtedly, induces the jobber to sell his own private brands is the desire to gain control of the market in certain products for which he sees there is likely to be a brisk demand, and to take advantage of advertising as a selling force. Since it is in the sale of these more lucrative lines that direct-selling manufacturers tend to appear, the jobber must do this in self-protection, if not for more positive reasons. Otherwise he will find that he has lost his most valuable trade to the direct-selling producers.

The development of advertising has without doubt exerted an influence on the private brand problem. Its part in arousing antagonism between jobber and manufacturer has just been mentioned. But it has a more positive influence with the jobber. Realizing the advantages of advertising and branding to demand creation, the jobber has seen that he may increase his clientele by advertising brands which only he can sell.[16] By developing his own factories or subsidizing manufacturers, as the case may be, he is assured of a steady supply of products with no danger of losing it to another jobber, and with less danger of losing trade through the refusal of a manufacturer to sell him any more goods. For even though a given producer refuses further supplies the jobber can usually find others who can make the goods. And, since the brand is his own, no loss in trade need follow. The larger

[16] The jobber, like the manufacturer, may sell the same or similar goods under more than one brand. Sprague, Warner and Co., for example, sell groceries under three brands, allowing one grocer in each community to have the exclusive sale of one brand. Thus their goods may, because of the three brands, be sold through three stores.

jobbers, furthermore, have high selling costs, and the introduction of advertised brands shifts some of the sales emphasis from price to quality, and so assists in the competition with smaller jobbers operating at a lower cost.

(4) Another reason which has been advanced is that by branding merchandise the jobber is protected against his own salesmen. Jobbers who depend, as most of them do, upon their salesmen to create and maintain trade, have sometimes found that much of their trade was not really their own, but came to them because of the personality of their salesmen. This has put the salesman in a very strong bargaining position, enabling him to threaten to take his customers with him to a competitor if his demands are not met by the jobber. Although this is heard of less now than in the past, it is still important. When the jobber handles his own exclusive brand of goods, his salesmen, to a greater degree, create a demand for these brands, as well as for the jobber's service, and there is, then, less danger of the loss of customers when popular salesmen leave the house.

(5) Of perhaps minor importance is the claim of the jobber that he can sell goods of better quality when he oversees their manufacture. It is probably true, at least, that he can in this way, be certain of more uniform quality, a valuable asset to him because his own trade suffers when a manufacturer's products are not as represented. A counter claim is made, however, by manufacturers that jobbers brand the surplus products and the left-overs of plants selling under their own brand, and that in no case can they exercise the same supervision over production that the manufacturer himself can exercise. Here again, no general statement can be made. The truth cannot be known in most cases, for conditions would vary with different jobbers and different products, as well perhaps as with different seasons of the year, when the volume of trade varies. Many manufacturers who sell under their own brand also sell unbranded goods to jobbers or retailers and even to both. This is often done as a definite policy.

Two well known drug manufacturers sell under their own trade name, but they also sell goods on which they will place the retailer's brand. And an aluminum cooking utensil company handles two branded and one unbranded line, in order to sell to different classes of dealers. Since the goods sold in these cases are not "left-overs" but are sold to the dealers with the purpose of building a permanent trade, the objection mentioned above would hardly apply. But it may, nevertheless, be true that in some lines, such as canned foods, left-over stocks or "seconds" are sold to dealers, unbranded.

Integration.—It is obvious that the jobber who controls his own factories, and in less degree even, the jobber who brands the products of independent manufacturers, as well as the manufacturer who does his own jobbing, are performing the same functions. But there is a difference in emphasis and in point of view. In one case, integration is taking place from the factory; in the other, from the market. The manufacturer does not always sell all his products through his own selling organization; at least, he does not always do all of his own jobbing; and the jobber, seldom, if ever, manufactures or even controls the manufacture of all the products he sells. Both are sports in our present system of marketing, and both point to the same tendency—the attempt to gain control of the market through the integration of manufacturing with marketing.[17]

Jobber Types.—Most jobbers confine their efforts to the goods carried by the class of stores to which they sell. These lines are often very wide, as with dry goods, hardware, grocery, and drug jobbers. And even more specialized lines, such as jewelry, paper, and musical instruments, include a large number of individual products. A few houses, like Butler Brothers and the American Wholesale Corporation, which supply general stores, carry an extremely wide range of products. Flour jobbers and shoe jobbers, on the other hand, confine themselves to a narrow line of merchandise. And there

[17] The same tendencies are evident in retailing. See p. 215.

are, as in the dry goods field, so-called "specialty jobbers" who sell only notions, silks, ready-to-wear, knit goods, dress goods, white goods, or linens. There are also manufacturers of single products, which are part of a wider line sold to retailers or producers, who job a few products made by other manufacturers, so that they can fill orders for a wider variety of products. This makes selling easier and less costly. Manufacturers of building materials and machinery, for example, sometimes do this.

National Jobbers.—The volume of business and the size of the territory covered also vary greatly. In the staple lines, three important classes of jobbers are discernible: the naticnal jobber, the district jobber, and the local jobber. The national or large general jobbers are located at such strategic centers as New York, Chicago, and St. Louis. New York in particular was formerly a center for national jobbers, because it was the port through which large quantities of European manufactures came into this country; and it had an excellent location in the center of American manufacture and consumption, with adequate transportation facilities for reaching outlying districts. But in recent years population has spread to the West and South, manufacturers have developed in America, and the manufacturing area has gradually spread with the expanding population; while improved transport has rendered other large cities commercially nearer these developing districts than is New York. There has developed, moreover, a retail demand for prompt and quick delivery of goods in small quantities. For these reasons New York has gradually lost its relative importance as a wholesale center. The large general jobbing business which formerly centered in New York has shifted in large part to Chicago, St. Louis, Denver, and the coast cities. The large jobbing houses located at these points are not, however, exactly like the national jobbers of former times. Their territory, in particular, is more limited.

District and Local Jobbers.—More recently small jobbing

houses have developed which are assuming the predominant place in staple trades. These are of two general classes. First are those jobbers who operate in areas extending for two, three, or four hundred miles from a given city; and second are the purely local jobbers who operate in a large city, or part of a large city, or in a small city and the cities and towns near-by. In the wholesale grocery business, for example, distinction has been drawn between national jobbers, district jobbers, and local jobbers. The latter are the predominant factor in the distribution of food products which are handled through jobbers. In 1915 the Curtis Publishing Company found that over one-half (53.33 per cent) of the grocery business passing through jobbing channels was handled by 2,768 local jobbers each doing less than a one million dollar business. Nearly one-third (32.4 per cent) of the business was done by 316 firms which were classed as "semi-sectional," and doing a business of between $1,000,000 and $4,000,000 each. Large sectional jobbers, of whom there were twenty-five, with a business running over $4,000,000 each, did 9.27 per cent of the business. And six national jobbers did but 5 per cent of the business, although their combined business was over $75,000,000.[18] Mr. Parlin in giving reasons for the continued growth and importance of the local jobber cited, among others, the fact that as such jobbers do not brand their product, whereas sectional jobbers do, national advertising manufacturers "more and more turn to local jobbers for distribution, and throw the powerful weight of national advertising behind the local jobber."[19] This tendency for local jobbers to develop is found in other staple lines.[20]

[18] C. C. Parlin, *An Address Delivered before the District Sales Managers of the Joseph Campbell Company* (1915), pp. 5–6 (Pub. by the Curtis Publishing Co.).

[19] *Ibid.*, p. 7.

[20] For an interesting discussion of the different types of dry goods jobber—(1) general dry goods jobber, (2) specialty jobbing house, (3)

Local Jobbers.—There seems to be no question of the trend toward local jobbing. Even manufacturers who sell to retailers are forced to recognize the factors which are behind this movement, and to establish branch sales districts and warehouses. National jobbers, likewise, have had to establish branches in order to compete successfully with this tendency.[21] There continue, however, despite this policy of the national jobbers, to be certain distinct advantages to local jobbing, especially in the merchandising of staple lines. Staples are sold primarily on a price basis. This is particularly true in their wholesale distribution, for the retailer wants to buy such products at the lowest possible cost. Here the local jobber seems to have distinct advantages. (1) He is in direct charge of his business and has no high administrative expenses for efforts directed solely to controlling a large organization. (2) He can keep in direct personal contact with his customers, thereby establishing a personal good will which makes selling easier, and (3) he can keep in close personal touch with credits.

The advantages of the local jobber are shown, so far as expenses are concerned, by consulting Tables V and VI at the end of this chapter. On the assumption that the smaller jobbers are the local jobbers clear advantages in expense are shown. The reader must be warned, however, that the whole story is not told by these figures. The rate of turnover, in particular, is not given, and this may have an important bearing on prices and profits. Furthermore, the larger jobbers are often manufacturers in some degree, manufacturing some of their own products and placing their own brands on many others. It is entirely possible that, considering this, a comparison of this kind is inaccurate, since the sales expense for selling manufacturers' goods is divided between the manu-

local general jobber, (4) small local jobbing house, (5) catalogue jobbing house, (6) drop shipper—see Cherington, *The Wool Industry,* Chap. IX.

[21] See E. C. Simmons, "A Half Century in Hardware," *Iron Age,* Vol. 77 (Jan. 4, 1906), pp. 145–148.

facturer and the local jobber, whereas the large jobber's expense includes both types of sales cost. Some of the tendencies shown in these tables illustrate the conditions which are thought to favor local jobbing. Those conditions which have not already been discussed will now be mentioned.

The salesmen of the local jobber cover a small territory intensively and live at home most of the time, thus reducing their expenses. And many orders are taken by the drivers of his delivery wagons. All of this keeps costs down. Delivery expense is likewise small, for the local jobber's warehouse is near his customers and the cost of making the small deliveries the trade demands can be kept down. This also enables him to make quick deliveries on short notice. Because of the modern emphasis on rapid stock-turns the local jobber has a distinct advantage from this fact, i.e., that his stock is nearer to the retailer than is the stock of the larger jobber whose headquarters are more remote. With the higher freight rates now prevailing, this advantage will be even greater, for the local jobber can make many deliveries by truck and the rail hauls from his warehouse to his customers are short.

TABLE V

Wholesale Expense Percentages for Different Volumes of Business and Different Lines *

Volume of Annual Sales	Groceries		Hardware		Clothing		Electrical Goods	
	T.† %	A.† %	T. %	A. %	T. %	A. %	T. %	A. %
Over $1,000,000......	10.3	8.8	23.5	18.8	17.8	15.6	—	—
$500,000 to $1,000,000	9.0	7.5	19.2	16.7	16.1	12.8	18.1	15.7
Under $500,000.......	7.2	6.3	17.8	14.9	—	—	17.0	13.3

* A. W. Shaw Company, *How to Run a Wholesale Business at a Profit* (1918), pp. xix-xxv.

† "T" means typical data, "A" means results which are thought to be attainable by the average firm in each class.

The sectional jobber, for similar reasons, has lower costs than the national jobber, but higher costs than the local jobber. In the grocery line the sectional jobber has been adopting a private brand policy, in part so that he will not be

TABLE VI.

*Wholesale Expense Distribution Percentages for Different Volumes of Business and Different Lines**

Annual Sales	Groceries			Hardware			Clothing		Electrical Goods	
	Over $1,000,000	$500,000 to $1,000,000	Under $500,000	Over $1,000,000	$500,000 to $1,000,000	Under $500,000	Over $1,000,000	$500,000 to $1,000,000	$500,000 to $1,000,000	Under $500,000
	%	%	%	%	%	%	%	%	%	%
Selling Expense	3.1	2.2	1.7	6.4	5.9	4.2	6.0	5.5	5.2	4.6
Administrative Salaries and Wages	3.0	2.2	2.0	7.9	6.2	5.3	4.0	3.5	5.9	4.9
Rent	0.4	0.6	0.5	1.0	1.2	1.2	1.2	1.4	0.9	1.0
Light, Heat and Power	0.1	0.2	0.1	0.2	0.2	0.2	0.3	0.3	0.1	0.1
Packing and Shipping	0.5	0.5	0.3	1.0	0.7	0.6	0.4	0.4	1.1	0.9
Insurance and Taxes	0.4	0.5	0.4	0.7	0.7	0.8	0.4	0.4	0.6	0.4
Office Expense	0.3	0.3	0.2	0.8	0.7	0.6	0.3	0.5	0.5	0.9
Bad Debts	0.7	0.5	0.5	1.1	0.8	0.6	1.2	1.0	1.5	0.9
Advertising	0.4	0.4	0.1	0.7	0.3	0.3	2.0	2.0	1.5	0.4
General Expense	1.6	1.6	1.4	3.7	2.5	4.0	1.4	1.1	0.8	2.9
Total Costs	10.3	9.0	7.2	23.5	19.2	17.8	17.8	16.1	18.1	17.0

* A. W. Shaw Company, *How to Run a Wholesale Business at a Profit* (1918), pp. xix ff.

forced to compete on a price basis with the local jobber.[22] It is interesting that the figures of Table VI, almost without exception, show that the selling costs (selling expense[23] and advertising), administration, packing and shipping, and bad debts appear larger with the larger houses.

[22] C. C. Parlin, *op. cit.*, pp. 4, 6.

[23] Sales force expense per net sales, however, has been found to decrease as the business increases in size. Harvard Bureau of Business Research, Bul. No. 14, *Methods of Paying Salesmen and Operating Expenses in the Wholesale Grocery Business in 1918*, p. 19.

CHAPTER IX

WHOLESALE MIDDLEMEN OF THE MANUFACTURER'S MARKET (*Continued*)

I

The chief purpose of the present chapter is to discuss the work of certain highly specialized marketing agencies, including those middlemen of exchange who operate mainly between the manufacturer and the jobber.[1] The middlemen of exchange are known by various names in different trades. Among them are commission or selling houses, manufacturer's selling agents, brokers, and purchasing agents. The general advantages and economies which result from their efforts will be described at this point.

These middlemen usually perform but few of the marketing functions. Their principal activity consists in arranging for the exchange of title to goods, and they serve the manufacturer through taking over his sales problem. Their sales service is particularly important to small manufacturers. Thus, hardware products are commonly manufactured by many independent firms, each making but a few special articles or a limited line of products. Only large manufacturers can afford a sales organization sufficiently effective to sell the trade directly. But the manufacturer's agent offers a selling or-

[1] For an excellent general discussion of middlemen functioning between manufacturer and jobber see L. D. H. Weld, "Marketing Agencies between Manufacturer and Jobber," *Quarterly Journal of Economics,* Vol. XXXI, pp. 571–599; see also the Reports of the Federal Trade Commission on canned goods, coal, newsprint paper, etc.; M. T. Copeland, *The Cotton Manufacturing Industry of the United States,* pp. 209–215; and P. T. Cherington, *The Wool Industry,* pp. 109–127.

ganization for these smaller firms, and by combining several products he is able to sell the trade at a low unit cost. Such ~~middlemen sometimes assist the manufacturers in their financial problems~~. This has been common in the textile trades, and is not uncommon in the hardware field.[2] In the grocery trade, in addition to the sale of staple canned foods, they have sometimes helped to introduce branded specialties.[3] By the combination in their operations of the output of several manufacturers, selling is usually accomplished at a lower unit cost than would be possible for the individual manufacturers. It has been shown that the manufacturer cannot usually afford a sales department which will reach the retail trade or the final consumer. Furthermore, he often finds it desirable to devote all of his time to the work of production. And for the same reasons he often finds it inadvisable to try to sell the very large number of jobbers and other large buyers found in some trades.

These middlemen serve the buyers as well, for, as they handle several varieties of a product or a single variety in large amounts, the various goods demanded, and sufficient quantities of each, can be purchased through one agency at a minimum of trouble and cost. And not only do these middlemen sometimes finance the manufacturers whose products they sell, but they may likewise render assistance to the purchasers who buy through them. They do little warehousing as a rule, and with the exception of the commission men, usually assume no risk and do no financing. It is safe to say that they are chiefly engaged in the work of buying and selling: not on their own account, but in assisting other parties to consummate sales. The financial assistance some-

[2] Cherington, *op. cit.*, p. 121.

[3] Certain grocery products, such as Kellogg's "Toasted Corn Flakes" and "Cream of Wheat," were introduced in this manner, although they have since been taken over by the manufacturer's own selling department. See L. D. H. Weld, "Marketing Agencies between Manufacturer and Jobber," *Quarterly Journal of Economics*, Vol. XXXI (1917), pp. 586–589.

times rendered is, nevertheless, important. But manufacturers and buyers are coming to have a stronger financial standing and are able more and more to dispense with this service, and as manufacturers grow in size and resources, they are often able to dispense with the exchange service as well.

(1) **Commission Houses.**—Commission houses, which are known to the law as factors and which are also called selling houses, are now found in the textile trades functioning as intermediaries between the mills and finishing houses, clothing manufacturers, jobbers, and retailers.[4] The selling house of the textile trade is of greatest importance to the smaller mills which are not near the market and to those mills which manufacture goods of seasonal design. Mills making staple fabrics, particularly the larger mills, more commonly sell direct or use brokers. The principal functions of the selling house are to sell the cloth for the mills and to finance them. This last function is more important in the case of Southern cotton mills, which are weak financially and removed from the great financial centers, than it is with the mills in the older manufacturing districts. Aid is rendered through direct loans, the endorsement of the mills' commercial paper, or through the guarantee of their accounts. In addition to selling and financing, such firms frequently furnish the mills with seasonal designs and patterns, sometimes hiring their own representatives to go to European markets to obtain the latest designs. They are located close to the chief selling markets, New York and Boston, and often have offices in several other cities. This enables them to keep constant watch of the styles and qualities the market demands, as well as to sense the volume of production in various lines.

The actual selling is done on a commission basis. The selling house takes orders several months before the goods are to be delivered, and orders the mill to make them. Sometimes goods are manufactured in excess of these orders and consigned

[4] See Copeland, *The Cotton Manufacturing Industry of the United States*, Chap. XI; and Cherington, *The Wool Industry*, Chap. VII.

to the house for sale. The commission varies with the work done, ranging from one and one-half to four per cent. When selling is difficult and when assistance in financing is rendered, or when accounts are guaranteed, the charge is greater. The selling house usually has the sole agency for each mill for which it sells, although a mill handling more than one kind of cloth sometimes has an agent for each. A single house usually handles the product of several mills and hence operates on a large scale. This reduces the unit cost of marketing, and enables the house to have enough goods to meet all normal demands made by purchasers.

Elimination and Integration.—Selling houses have been a feature of the cotton industry ever since its rise to importance in the late eighteenth and early nineteenth centuries and were early introduced into the wool and silk trades. Their persistence in the textile trades after they have been eliminated in many others seems to indicate that the function they fulfill there is a very real one. Most of the small and some of the large mills continue to sell in this manner. The position of the selling house does not appear, however, to be as strong to-day as it has been in the past. The same tendencies that have brought about the elimination of middlemen in other trades are operating here, although as yet with less effect. Here as in some other industries the continuance of many small producers is perhaps the chief consideration which has continued these middlemen as important distributors.

A close connection frequently exists between these firms and the mills for which they sell. This connection may be direct or it may result from having some stockholders, officers, or directors in common.[5] This has led in a number of cases to integration, the selling house becoming either the selling company for a mill or a chain of mills, or the selling department of an integrated organization. Other large mills have eliminated the selling house and have organized their own

[5] Cherington, *The Wool Industry,* Chap. VII.

selling house or department. In other cases, elimination has not gone so far—the selling house has become a sales agent, which operates under the close supervision and direction of the mill.[6]

Commission men, often called commission merchants, are also found in the sale of canned foods—fruit, vegetables, fish. As in other trades their operations are often hard to distinguish from those of the broker and sales agent, but the functions they perform are more extensive than those of either.

> "The commission merchant is usually a general sales agent, who handles the entire pack of the canner, who very often finances the canner, who in many cases bills out goods for him, and who collects his accounts."[7]

This commission merchant receives a commission of about 5 per cent, whereas ordinary brokers receive 2 or 3 per cent. The extra commission is a remuneration for the performance of extra services, such as financing and collecting accounts.[8]

(2) Manufacturer's Sales Agent.—Whereas the commission man receives goods from the manufacturer and sells them in his own name, then collects the proceeds and after deducting his expenses and his commission remits what is left to his principal, the manufacturer's sales agent operates within more narrow limits. The agent's authority as to territory, prices, and terms is usually definitely limited by a contract with the manufacturer.[9] Sometimes these agents are paid a salary, and are, therefore, practically salesmen, although they are more usually paid on a commission basis, or on a flat rate per unit sold. As has just been shown, when textile mills grow in size and financial strength they sometimes change from the commission basis to the selling agent basis of sale, in

[6] Cherington, *op. cit.*, p. 121.

[7] *Report of the Federal Trade Commission on Canned Foods: General Report and Canned Vegetables and Fruits* (May 15, 1918), p. 18.

[8] *Ibid.*, p. 19.

[9] *Ibid.*, p. 17.

order to gain a more direct control over the sale of their output. This is frequently a transition stage from complete dependence on commission houses to direct selling by the mill. The chief difference between the commission house and the manufacturer's selling agent of the textile trade is, as elsewhere, found in their relative freedom of action.

"Briefly, the distinction between the two is that the agency usually is financed by the mill and performs the selling operations on an agency basis rather than as a regular commission house. The control of selling operations, in other words, is kept in the hands of the mill." [10]

Selling agents in the hardware and grocery field are sometimes known as manufacturer's agents.[11] Instead of handling a single kind of merchandise they commonly sell an assortment of goods. But they usually handle only one kind of each product in their line, agreeing with each manufacturer to sell no competing product. In the sale of canned foods the sales agent is known as the "general sales agent." These general sales agents usually sell all, or a large part of the output of a packer. When they handle the entire output they arrange to sell it in all markets, often selling through "sub-brokers" to whom they, not the packer, pay a brokerage fee.[12] In some cases the general sales agent does not handle the entire output but has a large exclusive territory in which he sells.

The Federal Trade Commission cites three reasons for the employment of general sales agents by packers.[13] First, it may be the quickest and most efficient way.

[10] Cherington, *op. cit.*, p. 121.

[11] L. D. H. Weld, *op. cit.*, pp. 574, 580–589.

[12] *Report of the Federal Trade Commission on Canned Foods: General Report and Canned Vegetables and Fruits* (1918), pp. 17–19; *ibid.*, *Canned Salmon* (1918), pp. 21–22.

[13] *Ibid.*, *General Report and Canned Vegetables and Fruits*, p. 18.

"Although he usually has to pay a general sales agent a higher rate of remuneration [3 to 5 per cent] than the ordinary broker, he is willing to bear the extra expense because it obviates his carrying on negotiations with a large number of brokers and because he has confidence in the sales agent's ability to sell his pack to advantage." [14]

Second, a broker often advances money to the packer. In this case he usually insists on marketing the entire pack of the canner, and thus acts as a general sales agent. Third, close relations, such as were mentioned in the discussion of the textile trade, sometimes exist between the selling house and packing plants, and this may cause their transactions to be of this nature.

(3) **The Broker.**—The term "broker" is usually applied to that class of middlemen who make it their main business to bring buyer and seller together. Representing either buyer or seller, their only function as pure brokers is to assist in the consummation of sales, and as a result of their knowledge of the trade, in the assembly of products. Such middlemen usually specialize in one particular kind of product and know the market, the producers, and the buyers of their field thoroughly. Their powers are narrow—often they have the power to sell or buy only after confirmation of the transaction by the firm for whom they are operating. They are generally paid a flat rate per unit or carload, and because their functions are few and their expenses small their commissions are not large. In the sale of cotton fabrics the fee is commonly one-half of 1 per cent, in the sale of canned fruits and vegetables, 2 or 3 per cent, and in the sale of canned salmon,[15] 5 to 6½ per cent.

Brokers are of great importance in the sale of many food

[14] *Report of the Federal Trade Commission, op. cit.*, p. 18.

[15] *Report of the Federal Trade Commission on Canned Foods: Canned Salmon* (Dec., 1918), p. 47.

products, such as groceries, flour products,[16] canned goods.[17] The broker is important in the canned fruit and vegetable market because the canneries are small and because they are usually located in the producing areas, whereas the jobbers to whom the canned goods are sold are far away in the centers of population and ultimate consumption. Even such large manufacturers as sugar refiners use brokers. But because of their more effective sales organization, and lower unit costs they are particularly useful to the many small manufacturers of limited lines found in each of the fields mentioned. The broker is also found in the textile trades, where he sometimes operates between the manufacturer's selling agent and the purchaser, thus introducing another middleman operating on a larger scale and specialized even more highly than the selling agent. Brokers are also important in the sale of cotton grey goods, appearing between the treasurer of the mill or its selling agent and the converters.[18]

Summary.—The pure broker is an independent agent who merely brings buyer and seller together for a single transaction. Although he may deal in the name of his principal, he ordinarily accepts no responsibility, and the latter's confirmation of sale or purchase is usually necessary. Commission men (commission merchants, commission houses, and also selling houses of the cotton cloth trade) more often operate under contract, and deal in their own name with power to buy and sell without consulting their principal. They collect the bill and deduct their own fees and agreed-upon expenses before remitting. Very often they finance the prin-

[16] *Report of the Federal Trade Commission on Flour Milling and Jobbing* (1918), p. 12.

[17] "The services of brokers are used to some extent in nearly all branches of the food trade, though they are particularly conspicuous in the case of canned goods."—*Report of the Federal Trade Commission on the Wholesale Marketing of Food* (1919), p. 35.

[18] "With the expansion of the industry and the growing volume and diversification of products such a middleman secures an increasingly large place in the market organization."—Copeland, *op. cit.*, p. 216.

cipal through advances and endorsements. Both brokers and commission men tend to specialize in the sale of a limited variety of goods. Manufacturer's selling agents differ from commission men and brokers in that they are more closely bound by contract to their principal, and hence more closely under his control. The differences are largely in degree and the name a house is known by in the trade does not always indicate its exact service, but often far from it. In fact individual selling houses commonly make different contracts with each client, adapting the contract to the needs of the client.

(4) **Buying Middlemen.**—Among the middlemen who represent the purchaser rather than the seller, the broker is probably the most important. In fact, even when he is the direct representative of the manufacturer he can be of great service to his client's customers through his first-hand knowledge of the market and of sources of supply. Some brokers, particularly in the grocery trade, act as free lances, representing a manufacturer in one sale and a buyer in another, but keeping themselves unhampered in their general business by making no exclusive agreements with any manufacturer or buyer. Even when these brokers are the direct representatives of manufacturers, buyers for wholesale houses often prefer to deal with them. By dealing with brokers in each field they can most readily get in contact with the best sources of supply, often at a lower cost than would result from sending their own representatives. Inasmuch as the brokers through handling the product of several manufacturers can sell at a low cost per unit, they thereby reduce the cost of goods for their customers. Their operations, in the large, thus assist in the assembling of products by the wholesaler or manufacturer.

The buying of the wholesaler is also assisted by what are known as "purchasing agents" in the hardware trade and "resident buyers" in the dry goods business. These middlemen are sometimes the salaried representatives of the buying house,

sometimes independent representatives working on a commission basis. A great many wholesalers, importers, and large retail establishments have such representatives in foreign markets of importance as well as in the large domestic centers of trade.

The Merchant-Converter.—Another interesting middleman is the "merchant-converter" of the cotton trade.[19] He buys cotton goods in the grey, usually through a broker. He then has these finished, either in his own plant or on a commission basis by independent firms, after which he sells the finished cloth to the retailer, wholesaler, or cutter-up. The merchant-converter thus takes the entire responsibility for styles and for market conditions, after he has ordered or purchased the cloth from the mill; he usually pays cash or buys on a short term basis, and in case of need gives credit to the purchaser. He is a new factor who has entered the cotton trade in the past few years and is in part responsible for the gradual change taking place in the functions performed by the selling houses. In the case of the Northern mills, the financing activities of the merchant-converter may prove to be influential in assisting the mills to free themselves from the dominance of the older selling houses.[20] Through taking over the responsibility for designs and assisting in financing, the merchant-converter has made possible a higher degree of

[19] See Copeland, *op cit.*, p. 216.

[20] The whole market situation in the cotton industry is so interesting as to warrant a word at this point. Cotton cloth may, often does, go through the following hands: cotton mill, selling agent, broker, converter (who attends to finishing the grey cloth), cutter-up (clothing manufacturers, and shirt, collar, and cuff makers, etc.), wholesaler, and retailer. On the other hand some mills are highly integrated and sell finished goods to the large retailers. Although many changes appear to be taking place the middleman is holding his own, although in a new form. Thus, while selling agents are of diminishing importance the broker grows in importance and the new merchant-converter "is coming most rapidly to the front." See Copeland, *op. cit.*, pp. 216–219.

specialization in the industry and has thus made it possible to divide some of the style and credit risks.

II

Some Highly Specialized Functional Agencies.—Two other highly specialized factors in distribution which have made their appearance with the development of modern merchandising methods are the advertising agency and the sales promotion agency. The advertising agency in particular is now a firmly established institution in our market life. In addition to acting as a space broker for periodicals, a good advertising agency is able to offer the service of an organization familiar with advertising methods and media, and capable of outlining and carrying out an effective advertising campaign with better results and at a smaller cost than can any but the larger firms individually. Even the largest concerns usually retain such an agency to assist them. It is the same story of specialization and scale of industry. In contact with the advertising world, confining its efforts to advertising, and working for a number of clients, such an agency obtains certain advantages and economies. Most advertising agencies occupy a dual position as they usually receive their compensation in the form of a commission, about 15 per cent of the amount paid, from the medium in which advertising is placed, and yet they represent and advise the advertiser and often receive payment from him for special services rendered. Many of these agencies have achieved a remarkable success and have numerous satisfied clients.[21]

The sales promotion agency is not easily described. This term, however, is coming to be applied to individuals or firms who come into an organization from outside and endeavor to improve the marketing scheme. Sales promotion agencies en-

[21] See Cherington, *Advertising as a Business Force,* Chap. XV, for a discussion of advertising agencies, F. L. Blanchard, *Essentials of Advertising* (1921), Chap. XXIV, and Tipper, Hollingworth, Hotchkiss and Parsons, *Advertising: Its Principles and Practice,* pp. 408–416.

deavor to find out about the possible market, to ascertain whether existing selling methods are best adapted to the problems in hand, and to render occasional assistance to those in direct charge of the selling branch of the firm. Such service is also frequently rendered by the advertising agency.

III

Middlemen of Foreign Trade: (1) The Commission House.—Finally, three important middlemen found in foreign trade will be briefly described: the commission house, the export merchant, and the manufacturer's agent. As in domestic, so in foreign trade some manufacturers market their product directly, others market entirely through middlemen of one kind or another, and still others vary their methods as between different parts of the world. In the sale of the products of extractive industries, particularly in that of agricultural products, the middleman prevails almost entirely; and as in the domestic sale of farm and manufactured products, so in foreign trade, commission dealers are prominent. But in foreign commerce these commission merchants—or "commission houses," as they are also called in the United States, and "indent merchants" in Europe—represent the buyer rather than the seller. The headquarters of American houses are located in this country where they represent foreigners who desire to make purchases in America. Consequently they are not sellers of American merchandise but buyers, and they are paid for their services by the foreign buyer and not by the American shipper. But houses doing a commission business sometimes sell goods on a commission basis. In fact, the larger houses have both buying and selling branches, and are represented in some markets by other middlemen. They may, consequently, both buy and sell for their clients and may even take title to goods for resale. But selling for clients or buying on their own account is not the true commission house function.

Service to American manufacturer.—It is evident that the

commission house, when operating as a pure commission house, buys the domestic product of a given firm only when that product has been specifically ordered by a foreign purchaser, or, in case the commission house is allowed to choose, only when the product is thought best to meet his requirements. The house depends upon the foreign buyer for its business and is his direct representative in dealing with American producers. Inasmuch as such houses usually pay the domestic shipper his domestic terms, and themselves carry the credit risk of the foreign buyer when that is necessary, it is evident that they perform a very useful service to the manufacturer. In constant contact with the foreign market they are the source of many orders and a valuable medium for the sale of domestic products. All of the unfamiliar problems connected with ocean transportation, customs, tariff, and the like are attended to by the commission house. Very frequently producers do not even know the name of the foreign house to which they have sold. For all practical purposes their customer has been the commission house.

Service to the buyer.—These houses offer excellent service to the buyer. They save the trouble to which buyers would otherwise be subject in ordering many small lots of goods from a number of foreign houses and the further difficulties that might arise in the details of shipment and finance. For the commission merchant takes the order, distributes it among the various producers, pays the individual shipper himself, and collects and ships the goods in a single order, thus reducing the cost of freight, insurance, and financing. In addition to their services in buying, these houses frequently grant credit to the foreign house, a thing which many of the producers whose products they buy could not do. In direct touch with the producing market they can give their customers the benefit of a thorough knowledge of market conditions, purchase the latest styles and types, and as intermediaries between buyer and seller afford a convenient agency for the proper adjustment of disputes between them.

Although these merchants represent the foreign buyer, they frequently offer a valuable adjunct to American firms willing to spend time and money in demand creation abroad through advertising and traveling salesmen. Manufacturers sometimes send so-called "specialty salesmen" along with the salesman of the commission house, or alone, to teach foreigners how to use or operate their product as well as to push its sale. But the final sale and all details thereof go through the commission merchant. From this it may of course be but another step to the entire elimination of the commission house. It is now estimated, however, that in normal times from 50 to 70 per cent of our total exports are sold through these houses.[22]

No one commission house is likely to prove best for a single manufacturer: one will have a good trade in one part of the world, another in another. In some parts of the world, such as Europe and South America, merchants prefer not to deal through American commission houses,[23] whereas the trade of the Far East, of Australia, and South Africa is largely carried on through them. In conclusion it should be said that large numbers of such houses, as well as the merchants to be described next, are also important importers of products from the countries in which they sell, but as importers, they are likely to represent their foreign clients rather than the American buyer. They often sell raw materials for their clients and buy finished products to send to them.

(2) The Export Merchant.—Whereas the commission merchant is the chief medium through which American goods reach the foreign market, the export merchant is the principal agent through which English and many German prod-

[22] B. O. Hough, *Practical Exporting* (1919), Chap. VIII; E. W. Zimmerman, *Foreign Trade and Shipping* (1917), p. 112.

[23] This applies only to the general trade in manufactured products. Much of our export of cotton and grains is made to Europe through specialized dealers working only in a definite, limited field, as grain, or cotton. Many of these do business as commission houses.

ucts are exported. Although, as previously stated, many export houses sometimes act as merchants, sometimes as commission houses, and perhaps, as manufacturer's agents as well, the distinguishing characteristic of the export merchant is the fact that he buys and sells on his own account. Thus, so far as the selling activities of the American manufacturer or producer are concerned, it is the same as though he were selling to a jobber. The export merchant's profit results from the margin between the cost of goods and the expense of marketing them and the price which he receives. These merchants have an especially important field in undeveloped markets where they sometimes have a string of warehouses and even of retail stores. In England and Germany they exercise a very important function in financing foreign firms which are desirous of buying goods in the country in which the merchant is located. In England, in fact, some of these merchants have practically become financial specialists who loan their credit to foreign importers for the purchase of goods in England. The merchant pays the bills and takes in turn the notes of the foreigner. He often has no interest, directly, in the goods bought. The German houses, on the other hand, keep the trade more closely in control and themselves ship the goods to the foreigner, on credit, frequently making every effort to keep their clients from knowing the source of their product. As American trade develops, with greater demands for credit, it is likely that such merchants will grow in importance and will eventually assist in financing our trade.

(3) **Manufacturer's Agent.**—It is evident that neither the commission merchant nor the regular export merchant necessarily gives any real selling service ~~to the product~~ of particular producers: the one represents the foreign buyer in his purchases in this country; the other buys and sells on his own account. But as our foreign trade is passing from the export of staples alone, and manufactured specialties are developing which can be successfully sold only when demand is created for them, a more difficult selling problem

faces the American manufacturer who would win out in the foreign field. Consequently some manufacturers are marketing directly. But as most manufacturers cannot afford a sales organization of their own reaching all possible markets, a type of export middleman has developed to meet their needs, a middleman who renders a real sales service for the seller. These middlemen are known as manufacturer's agents or manufacturer's export agents.

The function of such a firm is to accept agencies for a number of manufacturers, usually in some one line—as textiles, electrical machinery, boots and shoes, dry goods—and, specializing in the sale of these commodities, to exploit the foreign market in the interest of its clients' wares. Such an agent will take over not merely the selling function but determine credit ratings, care for shipments, and make proper financial arrangements. For its services it charges a commission, usually a high one, as it performs many and expensive services. This is a comparatively new development and sometimes such service is sold by commission houses. This type of middleman is of growing importance and certainly offers a most logical method for disposing of the product of manufacturers who must create a demand for their product but are not able or willing to go to the trouble or expense of doing it themselves. In the opinion of at least one expert this is "the coming method of doing business through an intermediary." [24]

(4) Coöperation in Export Trade.—Somewhat similar to the work of the export agent are the functions performed by the combinations in export trade made legal by the Webb Act of 1918. Such associations are founded by manufacturers of related lines for the purpose of providing and controlling their own selling agencies. They are likely to perform functions similar to those just described.[25]

[24] E. E. Pratt, "Determining Export Policies" in the Business Training Corporation, *Course in Foreign Trade,* Vol. 3, pp. 18–20.

[25] See Eliot Jones, *The Trust Problem in the United States* (1921), Chap. XVI, and W. F. Notz and R. S. Harvey, *American Foreign Trade* (1921), Chaps. XI–XVII.

CHAPTER X

DIRECT MARKETING OF MANUFACTURED PRODUCTS

I

Tendency Toward Direct Marketing.—Previous chapters have shown that the trend toward large scale production, with its resultant demand for large markets and with keen competition in those markets, has forced manufacturers to exercise a more direct control over the distribution of their merchandise. There is a distinct tendency in the manufacturer's market to reduce the number of middlemen. This tendency has resulted in the main from the pressure of competition, which is frequently so great as to compel the manufacturer to stimulate and control the demand for his product. With competition keen the effort to control must be continuous lest the efforts of others divert the demand already created. The pressure of competition also forces manufacturers to great efforts in order to gain the advantages of large scale operation. These larger units in turn have made competition still more keen and so have become a further incentive to direct marketing.[1] Furthermore, with their organizations growing in

[1] Since 1907 a tendency toward integration of marketing functions has been present in the cotton manufacturing industry which has been caused by "the necessity for perfecting the merchandising organization, the desire of the selling house to justify its existence, and the narrowing of the margin between the cost of raw material and the selling price of the cloth. The fundamental cause, the one into which practically all of the others can be resolved, is keen competition arising from the increase in the size of the establishments and the growth of the cotton manufacturing industry in the South."—M. T. Copeland, *The Cotton Manufacturing Industry of the United States*, p. 173.

size and in financial power, and with the problems of organization for production nearer solution, many manufacturers find themselves in a position to devote their time and their growing financial resources to the problems of market control. A growing number of firms are, consequently, able to launch into the field of distribution and to attempt the direct control of their market.

Some manufacturers have found that they can sell more cheaply and more effectively if they eliminate the selling house and sell to jobbers and manufacturing consumers through their own sales organization. Some find that jobbers do not create a sufficient demand for their products and are perhaps unwilling to make the attempt. Particularly do those who sell their goods under brands which compete with the jobber's private brands, and those with new brands of goods of a kind for which the jobber has already created a large demand, meet with this obstacle.[2] Again, manufacturers of specialties find that the jobber is often, not merely unwilling, but unable to make the special selling effort that is essential to placing their products on the market in large volume. Other manufacturers have even gone so far as to control their own retail organization, or in other ways to sell directly to consumers.

OUTLINE IV. TENDENCIES WITH GOODS FOR PERSONAL CONSUMPTION

Kind of Merchandise:	*Sold by Manufacturers to:*
Unbranded staples	Jobber
Jobber's brand of staples	Jobber
Manufacturer's brand of staples	Jobber
Manufacturer's brand (bought in large volume by individual retailers)	Retailer
Specialties	Retailer
Specialties (when individual sales are large)	Consumer

Jobber Losing Ground.—Whereas, in the early years of the factory system the common method of distributing staple,

[2] See pp. 173–177.

factory-made, consumption goods was through the selling agent and jobber to the retailer, the prevailing method to-day is through the jobber and retailer alone. And even this system seems to be losing ground. For the necessity to create demand, which has developed with the increased competition in the sale of staple products, and the growth of new products of the specialty type which have to be "sold," have led the manufacturer to take over much, sometimes all, of the task of demand creation. When this is done there is left to the jobber and retailer only the work of physical distribution, together with some phases of financing and risk-taking. But even these fields are sometimes encroached upon until some manufacturers have entirely eliminated the jobber and often the retailer from their marketing plans. The distribution of typewriters, adding machines, cash registers, automobiles, meat products, men's factory-made clothing, and shoes, affords many examples of one or both of these tendencies.[3] Each of these products is one in which the individual sales by the manufacturer to retail dealer or final consumer, as the case may be, amount to a substantial sum. And, consequently, the manufacturer can afford to approach the buyer directly, and the buyer can afford the time necessary to see the salesmen and care for the other details of purchase. When the individual purchases are small, however, neither the manufacturer nor the buyer desires to deal directly. And it has been shown that it is in such cases that the middleman becomes important.

The problems of physical distribution have also been important in bringing about direct marketing. Particularly has the national distribution of perishable foods led the manu-

[3] "As an illustration of the number of methods of distribution employed by large producers, it is a fact that out of 102 concerns doing national advertising, 17 sell to jobbers, 18 to retailers, 11 through agencies, and 8 to consumers direct; 29 sell to both jobbers and retailers, 13 to retailers and through agencies, 4 to jobbers, retailers, and through agencies, 1 to both consumers and retailers, and 1 to jobbers, retailers, and consumers."—*Printers' Ink*, Sept. 12, 1912, quoted from Paul H. Nystrom, *The Economics of Retailing* (1915), p. 37.

facturers of that class of merchandise to market directly or to control physical distribution closely. Such producers as the meat packers, the National Biscuit Company, the Loose-Wiles Company, and some candy manufacturers have developed their own machinery for physical distribution.[4] The packers, for example, because their product is so perishable find it necessary to study the market closely and continuously in order to keep it properly supplied. This, they have found, can be done successfully only when they can feel the pulse of the market through their own distributing plants. The breakfast food companies, on the other hand, have usually been content with a close control over the jobber's service.[5]

II

Jobber Service Reviewed.—If, now, the services of the jobber to the manufacturer are summarized they will serve as a basis for ascertaining those conditions which determine, from the manufacturer's point of view, the desirability of placing the jobber in the channel of distribution, as well as those conditions which determine whether his efforts shall be supplemented or eliminated.[6] Very much the same arguments apply in determining the manufacturer's relation to other middlemen. From the point of view of the manufacturer the first and fundamental office of the jobber is to sell the manufacturer's product. So essential is this service, and so likely is the manufacturer to be critical of it, that any break between the manufacturer and the jobber is likely to

[4] In 1918, 85 per cent of the grocery stores reporting to the Harvard Bureau of Business Research bought all of their crackers and bakery goods (save those deteriorating rapidly and so of local production) from manufacturers, 50 per cent purchased all meats from butchers and packers, and 40 per cent bought candy only from manufacturers. For this and other data see Harvard Bureau of Business Research, Bul. No. 13, *Management Problems in Retail Grocery Stores,* pp. 27–30.

[5] *Op. cit.,* p. 28.

[6] This point is discussed from the retailer's point of view on pp. 134–137, 215.

begin at this point. Of very great importance, also, is the work of the jobber in carrying stocks. This necessitates buying and storing in large quantities so that the product will be constantly at hand to fill orders. It involves the prompt filling of orders, for the merchandise itself and for repairs, renewals, or supplies. This is a broad service varying greatly in its importance to the successful distribution of different products.

In the service just described it is clear that the jobber performs the primary market functions. But his service with the auxiliary functions is no less important. He may aid in financing by buying stocks, supplying a sales organization, advancing funds to the manufacturer, and giving credit to the retailer. He may help with the risk function by buying or contracting for the manufacturer's products and by stocking them, as well as in giving credit to retailers. He thus carries much of the burden of the risk involved from possible physical deterioration, demand failure, and credit losses.

Jobbers and Demand Creation.—The most important cause for the elimination of the jobber is the intense competition for sales. Because jobbers either will not or cannot give the service—demand creation; price maintenance; prompt delivery of products, parts, repairs, renewals, and supplies; storage, etc.—which manufacturers feel that they must have to enlarge their markets and retain them, the manufacturers have attempted to perform these services themselves. Jobbers generally handle a wide variety and a large volume of products. In serving the retailer they endeavor to supply any commodity which may be called for. They handle, consequently, thousands of articles in the grocery and hardware trades, hundreds of articles in the drug, dry goods, musical instrument, and paper trades, and large numbers in many other lines. The selling effort of a jobber must, consequently, be divided among many different kinds of articles and among several competing articles of the same kind. It therefore follows that the average commodity receives no special sell-

ing effort on the part of the jobbing organization. Such sales as are made are due to a large extent to the fact that the article is shown in the catalogue, that it allows a good margin to the retailers, or is particularly satisfactory to the consumer and so helps to build up the dealer's trade.

This is the condition which the manufacturer faces, unless some special reason exists for the jobber's pushing his particular product. Such reasons may arise from the fact that the article offers a wider margin of profit than competing articles; or that it is of such quality and gives such satisfaction in use that consumers demand it, and, consequently, it is easily sold; or from the fact that it bears the jobber's own brand. Again, the product may be branded by the manufacturer, but may be satisfactory as to margin and quality; or it may be a product for the sale of which the jobber is given an exclusive agency for a particular territory. Finally, it may be merchandise for which the manufacturer through skillful sales effort has created such a demand that the jobber finds that a minimum of sales effort on his part will achieve large results.

Products the Jobber Sells Best.—These facts have an important bearing on the kind of products that can be advantageously sold through the jobber. They must usually be staple products commonly demanded by consumers, and consequently by retailers. They must be products for which it is not difficult to create a demand, or for which the producer has created a demand. Products which are already demanded are looked upon with the greatest favor by the jobber. He is very generally indifferent to a new product, particularly if it is but a new brand of an old commodity. He is likely to have in his stock several of the same kind, and so far as he is concerned there is little need for another. His interest can be aroused only if the new product is easy to sell, or offers a wider margin than other products of equal quality which he is already distributing. Otherwise, to take on another product simply ties up more capital in stock; and, if he really tries to sell it, involves effort which may not increase his

total sales at all, but merely divert demand from one of his products to another. Even if the total demand for this kind of product is increased, it may be at the expense of other kinds of products, and in any case the cost of creating the new demand may offset any anticipated profits.

The Jobber and New Products.—A new product, consequently, is not usually well sold by the jobber. It will take too much of his time to give it the kind of sales effort necessary to create a suitable demand. This he is unwilling to give, and, furthermore, he may be unable to give it. He does not as a rule advertise individual products and his sales force does not have the time to devote to new products without slighting the many others which it is organized to sell. In addition to this, the jobber's salesmen may not have the qualities necessary to sell the new article, particularly if it is a specialty. It follows, then, that if a product has real merit, if it is of a kind which is in demand, if it allows a good margin to the jobber and the retailer, it will be sold well. But if no demand exists for it, and it is therefore hard to sell, the jobber's efforts alone are not likely to prove successful. In fact, the jobber is likely to refuse to handle it at all.[7]

Jobber Brands.—The private brands under which some jobbers sell are also a cause for difficulty. For it is natural to assume that a jobber will push his own brand rather than a similar product branded by a manufacturer. The reasons for branding by the jobber were discussed in Chapter VIII and the advantages arising from the general use of brands will be considered in Chapter XIX. It is simply necessary to point out now that when a jobber has a branded product of his own he may well refuse to handle a competing product branded by a manufacturer. And if he does, the manufacturer is likely to be dissatisfied with the results.

The Manufacturer Who Does Not Brand.—The manufacturer who does not brand or advertise his product and

[7] L. D. H. Weld, "The Economics of Advertising," *Printers' Ink*, Vol. 104 (July 11, 1918), p. 101.

who sells to the jobber is not in a strong strategic position. This is particularly true if his article is easily duplicated, as is true of most staples. Inasmuch as his product goes into retail channels as the product of the jobber, and not under his own name, such a manufacturer, unless he is particularly capable as a producer, is likely to lose his market at any time to another producer who will sell to the jobber at a lower price. The jobber's success is not tied up with the success of any particular manufacturer whose products he buys. He has, consequently, little interest in the success of the manufacturer. From this it follows that if the individual manufacturer would increase and control the market for his product he must sell it himself, or else utilize some method of tying the interest of the jobber more closely with the success of his own product. It is for this reason that manufacturers who depend entirely upon the jobber for a market for their product, commonly remain small and unknown, unless they have peculiar advantages in production. Their business, likewise, is precarious, for their market is a few large jobbers, even a single jobber, and such a market is easily lost. These facts have led many manufacturers, even of staple lines, to brand and advertise their products. But many jobbers resent the attempts made by the manufacturers to "help" sell, and their efforts to control the marketing of their product. These efforts include, for example, advertising, sending out salesmen directly to retailers, and endeavors to control the price policies of the dealers involved after the product has been sold by the manufacturer. Under such conditions some manufacturers have been forced to try their own hand in the market or else to succumb before those who do.

Summary.—We may conclude from what has gone before that staples, goods of a kind for which a demand among consumers need not be created, are the products most advantageously handled by jobbers. It has likewise been shown that specialties, products for which a consumer demand must be created, are not likely to be well sold by jobbers. It has

been further shown that individual manufacturers of staple products cannot expect the jobber to give to the sale of their particular product the selling effort which they desire. This is particularly true when the jobber sells competing goods under his own brand. These conditions lead to direct sale by manufacturers. Such direct selling is of two kinds: one to create a demand for a new kind of product, and the other to create a demand for a particular manufacturer's product, but of a sort already demanded. But these simply show the two extremes. There are perhaps few staple products for which more demand may not be created; and there are few specialties which are not manufactured by more than one producer, and which to many consumers do not assume the importance of staple commodities. The average manufacturer is interested, consequently, both in creating a larger demand for his own product, and in getting as much as possible of the existing demand and of any newly created demand for that particular kind of product.

III

Cost the Determining Factor.—The interest of the manufacturer in enlarging, retaining, and controlling his market would naturally lead him to sell his product directly to the retailer, if not to the final consumer. But the element of cost may deter him to such an extent that he can simply supplement the efforts of the jobber in some way. So much is heard of the "middleman's profit" that one is likely to be led astray on this point and to feel that great economies result from lessening the number of independent agencies in the marketing chain.[8] There is reason to believe, however, that the middleman's profit is not usually large.[9] It is probably no greater

[8] At least one careful investigator feels that often the cost has been increased as a result of the elimination of middlemen. See L. D. H. Weld, "Marketing Agencies between Manufacturer and Jobber," *Quarterly Journal of Economics,* Vol. XXXI (Aug., 1917), pp. 571–573.

[9] See pp. 288, 511–519.

than the additional profit the manufacturer would feel that he must make to cover the additional investment, trouble, and cost which he must bear if he performed his own sales activities. It is expensive to run an extensive sales organization; and a large amount of capital must be supplied by the manufacturer who markets around the middleman, for he must duplicate the middleman's machinery and is likely to have a smaller volume of business in a given territory than has the middleman with his wider range of goods. He is also likely to have difficult problems of administrative control. The net result, therefore, may well be a higher unit cost of selling. Even though he might consider his sales organization as supplemental to his producing activities, no wise business man will invest willingly in a sales organization without the expectation of receiving his usual profit from the increased investment. It takes so much capital to start such a project—the costs of operation are so great, the risks to be borne so many, and the difficulties to be met so numerous—that many manufacturers hesitate to undertake the selling of their own product even when they are dissatisfied with existing agencies. Other manufacturers have failed in making the attempt; some who have made the venture now wonder if they have not made a mistake; and some have already returned to the jobber.[10]

[10] "Out of 139 manufacturers who stated whether they had changed their selling methods during recent years, twenty-three said they had changed from selling through jobbers to selling direct to retailers, and fourteen said they had changed from direct sale to selling through jobbers. The number who had gone back to jobbers is rather large as compared with the number who had forsaken them, but this does not affect the general truth that advertising tends to lead to more direct sale.

"Most of those who had gone back to jobbers had expected to sell through this channel in the first place, but when they put their branded goods on the market, jobbers had refused to handle them, and it was therefore necessary for the manufacturers to go direct to retailers in order to build up their distribution. After an effective demand had

An Illustration.—To make this aspect of the problem clear, let us contrast the jobber with the manufacturer of, say, a grocery product.[11] The grocery jobber handles most of the commodities the ordinary grocer wishes to carry, and an order usually covers a large number of products totaling a respectable sum, so that the expense of the salesman's call, the determination of the credit risk, delivery, and the other expenses connected with the sale are spread thinly on each product sold. The salesman of the manufacturer of any one of these products will probably not sell many more items of his product over a period of time than will the jobber's salesman. But the expense of the manufacturer's salesman's call and all other expense connected with the sale must be borne by the single article.

It is obvious that much of the reasoning which has just been used does not apply where the facts differ. They would differ, for example, (1) when a single line of goods—such as shoes, men's clothing, and meat—is the main product sold by the retailer who buys them; or (2) in cases where the value of a single purchase is great enough to warrant the buyer's seeing the special salesman of that particular product—as with typewriters, cash registers, adding machines, automobiles, etc.; or (3) when the manufacturer makes or distributes so wide a variety of products that his line is comparable to that of the jobber. This was the case with the grocery business of Armour and Company before they divided their grocery business after the "consent decree" of 1920.[12] In fact, there is reason to believe that the packers' costs for distributing

been established, their goods were then put through the jobbers, who were glad enough to handle them."—L. D. H. Weld, "The Economics of Advertising," *Printers' Ink,* Vol. 104 (July 11, 1918), p. 101.

[11] This is a rather extreme illustration to bring out the point, for in but few lines do jobbers handle so many products and on so small a margin.

[12] Even with groceries eliminated this continues to be true of the larger packers because of the wide range of merchandise they sell.

groceries were less than the costs of the wholesale grocers.[13] But it is only when the manufacturer handles a "line" of groceries, such as canned goods, pickles, cookies and crackers, that he can compete with the grocery jobbers on a cost basis. In fact but few manufacturers even of a "line" of grocery products have thus far attempted direct sale to retailers.

Manufacturers Must Duplicate Service of Jobber.—The jobber is in close contact with his trade, and makes frequent sales calls so as to get orders whenever the merchant has need;[14] his warehouse is near at hand so that deliveries can be made on short notice and economically. He buys in large quantities and breaks up his large purchases near the retail market, thereby saving transportation costs. In close touch with his customers he can establish a personal clientele and watch credits and collections with great care. The manufacturer who would market directly to retailers or consumers must perform this work or labor at a great disadvantage. In order to meet this necessity the manufacturer who does not use jobbers commonly establishes branch houses,[15] such as those found in the sale of canned foods, meats, and meat by-products, National biscuits, Heinz pickles, farm implements,

[13] See *Report of the Federal Trade Commission on the Meat Packing Industry*, Part IV (1919), pp. 50–52.

[14] "Of all the wholesale grocers selling to local trade, 9 per cent called on their customers daily, 9 per cent three times a week, 16 per cent twice a week, 60 per cent once a week, and the remainder once in two weeks. . . .

"Among the wholesale grocers selling to customers within 25–300 miles, 52 per cent called on these customers in the outside districts once a week, 42 per cent once in two weeks, and the remainder once a month."—Harvard University, Bureau of Business Research, Bul. No. 14, *Methods of Paying Salesmen and Operating Expenses in the Wholesale Grocery Business in 1918*, p. 19.

[15] "National jobbers," however, labor under much the same difficulties and have also been forced to establish branches. See E. C. Simmons, "A Half Century in Hardware," *Iron Age*, Vol. 77 (Jan. 4, 1906), pp. 145–148.

automobiles, typewriters. In other words, the manufacturer must practically duplicate the jobbing service in the performance of all functions. There are, furthermore, disadvantages which are not felt by the jobber. For the manufacturer must have hired employees in charge of his branches and the sales forces are likewise removed from immediate supervision. This necessitates the introduction of branch accounting and supervision, with the attendant costs and the loss in effectiveness which the use of salaried supervision of distant business involves.

Advertising and Direct Marketing.—One of the first steps taken by a manufacturer who desires to control his market is likely to be an attempt to enlarge demand through advertising.[16] Then in order to follow up the advertising and make certain of results he is likely to consider it necessary to take over other jobbing functions. He may even find it desirable to take over the physical distribution of the merchandise. The natural tendency, once the movement is started, may well lead to the entire elimination of the jobber's services. Some manufacturers feel that they fare better when their own trained men sell and distribute their products. They discover that many retailers, particularly the larger ones, prefer to buy "over the head" of the jobber, that jobbers are not always willing to keep large enough stocks in storage to supply the demand, and, finally, that direct selling gives a control over quality of service, general policy, and prices that it is difficult to attain through the jobber.

The very fact that the manufacturer is creating a demand for his product, and is endeavoring to control the activities of the jobber who distributes it, may arouse the antagonism of the jobbers to such a degree that the manufacturer will feel forced to take these further steps. On the other hand, manu-

[16] Even at this point the manufacturer must decide whether he will "go around" the functional middlemen of the advertising field, the advertising agency, or whether he will use the services of one middleman in eliminating those of another.

facturers are sometimes compelled to create a demand for their product before the jobber can be induced to stock it, because the latter does not feel that it is worth his while to sell it with his own sales organization.[17]

It is not clear that the cost of distribution is lowered when middlemen are eliminated.[18] One of the greatest costs of the distributive organization of the manufacturer who sells to retailers and endeavors to create a consumer demand for his product, is the national advertising bill, an expense that is largely paid by the manufacturer himself. It is not as yet an important cost to wholesale middlemen.[19] The cost of direct demand creation whether by advertising or salesmen is generally a very heavy charge and one which must be financed by the manufacturer if he sells his product himself. On the other hand, it may well be true that the sales department of a large firm, especially of one handling a large "family" of related products, can operate as economically as any jobbing house selling the same articles, and the results to the manufacturer may prove to be far superior.[20]

Conclusion.—Dissatisfaction with prevailing methods and channels of distribution is at the base of most attempts to go around middlemen. The reasons for this dissatisfaction have been reviewed. And it has been further shown that many manufacturers have their production problems sufficiently routinized to devote their individual time and attention to marketing. Finally, a growing number of manufac-

[17] See L. D. H. Weld, "The Economics of Advertising," *Printers' Ink*, Vol. 104 (July 11, 1918), p. 101.

[18] See Chap. XIV.

[19] Some "national" jobbers, however, brand and advertise their products on a national scale, and some so-called manufacturers may have their products made in large part by other manufacturers, but brand them. Ingersoll watches were originally made in this way.

[20] See E. B. Merritt, "How Armour & Co. are Solving their Vast Selling Problem," in *Printers' Ink*, Jan. 23, 1913, pp. 3–10; and "Reasons back of Armour's Selling Policies," in *Printers' Ink*, Feb. 27, 1913, pp. 3–8.

turers have reached a position of financial power, and increased financial resources tend toward direct marketing. This is for two reasons: first, the manufacturer is thereby relieved from dependence upon the middlemen for financial assistance, direct and indirect.[21] Second, the initial costs of initiating the direct marketing of a product—particularly one which is sold in small quantities to final consumers—are likely to be so great that only a manufacturer with large financial resources can undertake it. This is true in large measure even when manufacturers sell to retailers, and do not try to retail their product. It is especially true when the manufacturer's product is but a small part of the dealer's stock in trade.

Nevertheless, even though marketing ability and financial resources are at hand, and even though a manufacturer may be dissatisfied with existing means of distribution, but few manufacturers completely supplant existing agencies with their own. Most of them find that to market their product directly would be so costly that they could not compete on a price basis with those who utilize existing agencies. Seldom indeed does the manufacturer eliminate the retail dealer. He may do his own jobbing. But more commonly he supplements the dealer's efforts and coöperates with both jobber and retailer.

As the basic functions of marketing can be broadly divided between those which bring about an exchange of ownership, those concerned with physical distribution, and those which are auxiliary to exchange and physical supply, so manufacturers frequently undertake for themselves some aspects of their marketing problem and leave the others to established middlemen. When a manufacturer carries on an advertising campaign for his product, or sends his own salesmen to push it among the trade, he often continues to have it delivered through jobbers and retailers, and even through selling houses to the jobber.

[21] See pp. 342–345.

On the other hand, when the jobber or commission firm takes orders for products which are delivered by the manufacturer, the latter is caring for the physical distribution of his product, the middleman for demand creation. When there is a high degree of coöperation between manufacturer, jobber, and retailer, each may perform part of the work of demand creation, as well as part of the work of physical distribution, financing, and risk-taking. The manufacturer may utilize national advertising and salesmen to create demand; the jobber, in addition, will push the article through his sales organization; and the retailer will utilize local advertising and his store organization. Carloads will be sent from the producer's warehouse to retailers on orders which the jobber takes; the jobber will store enough of the product to supply small shipments and rush orders; and the retailer in each case will attend to the final sale and delivery of the product to the ultimate consumer. Middlemen may advance cash to the manufacturer, pay cash on delivery, or receive credit, and other means of dividing the work of financing and risking may prevail as the product goes on its way.

CHAPTER XI

RETAIL DISTRIBUTION

The Retail Service.—The service of retailing is to supply the individual consumer with the goods he desires for personal consumption. To do this the retailer must anticipate the needs of his trade, assemble the goods desired, store them, and have them ready to be delivered from convenient points. He must finance these operations, bear the risks involved, and create a demand for his services. The retailer is the truest type of "areal" middleman, for he performs all of the marketing functions.[1]

To retail meant, originally, to cut again, to divide into pieces; and this definition suggests an important economic justification for retailing. For most retailers buy in quantities the products which they anticipate the final consumer will demand, and divide these large quantities into the smaller amounts the consumer is willing to purchase. It is usually too expensive and too troublesome for the manufacturer to sell "direct," or for the consumer to buy "direct," for personal consumption. The individual exchanges are too small. By assembling at convenient points, from numerous sources, the various kinds of products which consumers demand, the retailer enables the consumer to purchase a variety of goods in small amount, on short notice, and with a minimum of trouble. Incidental to these services, but of growing importance with the increasing variety of consumer desires and the decreasing storage space in the average home, is the fact that the retailer finances the purchase and arranges for the transportation of goods to points near the consumer and stores them there

[1] A. W. Shaw, *Some Problems in Market Distribution,* pp. 76 ff.

until they are wanted. He also bears the risk of style changes and of physical deterioration, and extends credit to the consumer.

I

Types of Retail Establishment.—There are five outstanding types of retail establishment in America. In the order of their rise to importance they are: (1) the general store, sometimes called the country general store, because of its prevalence in rural communities, (2) the "unit" store, (3) the department store, (4) the mail order house, and (5) the chain store. The trading post of early American history has been entirely superseded in the United States, although it survives in the trading post of the trading companies of the far Canadian north. Coöperative stores cannot be considered important in this country, although they grew in importance during the World War.[2]

(1). **The Country General Store.**[3]—Of modern retail stores the country general store was the first to develop, and, although now of decreasing importance, it is still found at village cross roads, in small country towns, and in larger towns remote from city stores.

"The general store is perhaps the most typical American development in merchandising institutions, since very few like it are to be found anywhere else in the world. The old-time general store distributed dry-goods, hardware, groceries, drugs, and even liquors. It was frequently the location of the post-office, and served as the village social center for the men. The old box stove, the rickety chair or two, the near-by barrels, and the sawdust spit-box, were the almost universal furnishings that equipped it for its social services. Here politics, religion, and neighbors were discussed. It may not be too much to say that here the tariff question, the government bank, internal improvements, foreign policies, and other important government matters were ulti-

[2] The coöperative movement is discussed in Chap. XIII.

[3] The buying of local produce by the country general store was discussed briefly on pp. 49–50.

mately settled. . . . With all its inefficiency, its wasteful methods, and its shortcomings, as a retail establishment, it must be said that it successfully served its day as probably no other type of institution could."[4]

But as the standards of consumption improved and became more various, and as new processes of production turned out larger and larger varieties of products, as better roads, suburban trains, and superior communication facilities appeared, specialization developed in the retail business and the unit store emerged, a store which specialized in the sale of particular classes of goods.

(2). **The Unit Store.**[5]—The unit store is to-day the prevail-

[4] Paul H. Nystrom, *Economics of Retailing* (2d ed., 1919), pp. 23–24.

[5] This is a term used by Professor M. T. Copeland in a paper "The Scope and Content of a Course in Marketing," read before the Association of Collegiate Schools of Business in May, 1920, and printed in the *Journal of Political Economy*, Vol. XXVIII, No. 5 (May, 1920). He states: "A unit store is a store without an elaborate departmental organization that is owned and managed as an independent unit for the sale of goods through personal salesmanship. Unit stores are used most extensively for the distribution of merchandise, such as groceries, hardware, agricultural implements, shoes, men's clothing and furnishings, jewelry, cigars and tobacco, and drugs.

"Unit stores furnish the most numerous outlets for many kinds of merchandise. They provide the only means whereby large numbers of consumers can be reached regularly. They are adaptable to the service requirements of their patrons. Frequently the proprietor of a unit store has built up a strong personal clientèle. The market for merchandise distributed through unit stores is not dominated by a few large powerful buyers.

"A manufacturer who elects to distribute his product through unit stores, however, encounters difficulty in inducing a large number of individual retailers to handle his product effectively. While there are many notable exceptions, nevertheless a substantial number of unit stores are not operated efficiently. The selection of this type of store as the marketing agency, therefore, presents a series of difficult, complex problems."

A more minute discussion than it is possible to give here is found in that article, pp. 381–387. The whole article is reprinted in M. T. Copeland's *Marketing Problems* (1920), pp. 1–23.

ing means of retail distribution in both town and city, and, although it is familiar to all, later discussion will be clarified if its main characteristics are briefly enumerated at this point. Such a store is owned and operated as an independent unit. It handles a restricted line of products—meat, groceries, drugs, hardware, jewelry, coal, candy, dry goods, millinery, athletic goods, confections—and consequently need not be elaborately departmentized. The reasons for the strength of the unit store in its competition with department stores, chain stores, and with mail order houses have been described as follows: [6] (*a*) convenience to the customer, as illustrated by the "corner" grocery store; (*b*) complete stocks, which can be kept more complete than those of the average department store or mail order house. This is particularly true of the larger city specialty stores; but it is also true of rural or suburban stores, since they are usually competing with small department stores or country general stores. Further advantages are: (*c*) the personal service of the proprietor to the public, which frequently results in his building a strong personal clientele, over whose purchases he possesses a large influence; (*d*) the possibility of rapid turnovers, which on the average, however, appears not to have been realized; and (*e*) low expenses. Recent investigations from a number of sources seem to indicate that the selling expenses of department stores at least are higher than the best, perhaps than the average, of competing specialty stores.[7]

The same source points out various disadvantages of the unit store. First of these is (*a*) the limited trade area from which the neighborhood store in particular draws, and which precludes the possibility of a large business. (*b*) Newspaper

[6] Ralph Starr Butler, *Marketing Methods,* pp. 62–69. Butler calls them "specialty" stores, but this term usually has a narrower meaning, referring to a type of urban unit store which utilizes aggressive sales efforts or specializes in catering to a more or less exclusive clientele.

[7] See, for example, Nystrom, *op. cit.,* pp. 263–266. This point will be discussed again in Chap. XII.

advertising cannot be used to the best advantage, for the cost of effective advertising in view of the limited patronage—particularly of the neighborhood store—is often far too great in relation to sales to warrant the expenditure. This is particularly true of advertising in large newspapers which have a much wider circulation than the trading area of the small store. (*c*) To the person desiring to buy many articles the limited line carried by the unit store is a disadvantage as compared with the many lines of the department store, or even with a varied line of goods under one roof or in one catalogue of the mail order house.[8] (*d*) Certain buying weaknesses also exist; many manufacturers give greater quantity discounts to mail order, chain, and department stores; and through their extensive buying organizations larger establishments are also better able to keep in close touch with the market, and to gain any advantages which superior market knowledge may yield. (*e*) Unit stores are liable to be poorly managed. Although this is not an inherent weakness it is very common. In fact, it is perhaps true that the difference between the small store and its large competitor is due fundamentally to the superior managing ability of the proprietor who started the latter. If the owner of the unit store were a better manager, he would very likely branch out into larger lines of merchandising. Recent investigation shows, nevertheless, that many small unit stores are operated with remarkable efficiency.[9]

The unit store is the "regular" dealer at retail. And the

[8] Many housewives who are within shopping distance of good stores of the specialty type prefer to order many of their goods from mail order houses because less time is necessary to select the goods from the catalogue and make out the order than would be taken in going from store to store looking over the stocks of each kind of article bought. A similar advantage is offered by department stores.

[9] See the report of the Northwestern University Bureau of Business Research on the retail clothing industry—*Costs, Merchandising Practices, Advertising and Sales in the Retail Distribution of Clothing* (1921)—hereafter referred to as *The Clothing Survey.*

great bulk of staple commodities, as well as of many specialties, is distributed through such stores.[10]

II

Technical Aspects of Retail Development: Transportation and Communication.—Important technical developments of the last half century have had a marked effect on both the methods and policies of retail stores. One of these developments is the improvement of transportation and communication. Although these improvements are usually thought of as they have affected the wholesale trade, both domestic and foreign, they have influenced retail trade as well. Because of these changes, it is now unnecessary for the retailer to stock heavily in normal times. A call on the telephone, a letter, or a telegram to the near-by distributing agency of jobber or manufacturer serves to start goods on the way, and they are soon delivered by freight, express, parcel post, or motor truck. There is thus made possible to the retailer a very close correlation between supply and demand.

But these improvements have also developed new kinds of competition. Department stores have become important in our cities, and city stores generally have gained trade which formerly went to the country general store and to the unit store in the small towns. The products of remote parts of the world have been made available, stimulating new kinds of retail business and rendering existing trade more complicated. A wholly new type of business, the mail order house, is rendered possible. And, finally, this development of communication and transportation has changed the consuming public to one which, educated through travel and the press, has acquired a more varied and a more exacting taste.[11]

[10] The nature of large retailing will be described in the following chapter, and the remainder of this chapter will be devoted to the general conditions and problems of retailing.

[11] This has had its effect on the character of goods sold and the nature of the service provided. In explaining the "drift" of consumers toward

Manufacturing Progress and Retailing.—Rapid progress in manufacture has likewise had marked effects in the retail field. New goods are constantly brought on the market, either as modifications or duplications of commodities already on the market or to meet heretofore unsatisfied and unrecognized wants. Among such articles are the safety razor, vacuum cleaner, automobile and motor truck, cash register, breakfast foods, canned foods. These new commodities have caused new stores to develop, have necessitated new departments in old stores, and have complicated the retailer's buying and selling problems. With the development of manufactured pharmaceutical products much of the time the druggist formerly spent in preparing prescriptions and providing remedies is no longer needed for that purpose, and to this extent he has become more largely a distributor of pills and patent medicines. But on the other hand modern manufacture has provided the drug store with such side lines as toilet articles, photographic supplies, stationery, "soft drinks," and confectionery. Book stores have multiplied with the increasing growth of the publishing business. The development of canning factories and of packaged products has worked a revolution in the work of the grocer.

The increased variety of goods now offered for sale has also made buying more difficult. And this has helped to continue the jobber as an important feature of the market at a time when improvements in transportation, communication, and the financial status of retailers and manufacturers tend toward his elimination. The increased use of national advertising by

quality merchandise, C. C. Parlin declares it to be due to (1) finding out that good grades of goods are better values in the end, (2) the opportunity of "shopping" in department stores which has made women better buyers, (3) the part national magazines play in carrying style and quality ideas to remote places, so that last season's goods cannot be sold anywhere as up-to-date merchandise, (4) to the fact that women have become educated to the importance of good buying.—C. C. Parlin, *The Merchandising of Textiles* (Pub. by the National Wholesale Dry Goods Association), pp. 33–35.

manufacturers and wholesalers has so stimulated the demand for certain products that the retailer is often forced to carry them against his will in order to keep the trade of customers who are induced to call for them by the sales efforts of their producers. These advertisers have made the dealer's position even more difficult by means of the propaganda by which they have tried to educate consumers against the substitution of other goods for the advertised product. This increases the variety of such goods he must handle and slows up the turn of his stock, and frequently the profit on these lines is relatively small. Such a condition tends, of course, to offset the advantages which are derived from improved transportation and communication. Furthermore, the products of remote areas have been made available, and these have added further to the variety of goods demanded.

This increased variety of merchandise, together with the fact that a greater volume of goods per capita is being produced than in former years, has caused retailing to become relatively more important. In addition to the new commodities now produced, factories manufacture goods formerly made in the home, and these, when sold back to the home, call for retail service not formerly needed. As clothing—first men's and then women's and children's—butter, and cheese have come to be made in factories, need arises for retail service which was unnecessary when these goods were made in the home. The large scale manufacture of ready-made clothing has added men's and women's clothing departments to department stores and has brought in three new specialty stores, the men's and the women's suit shops and the children's shop. The extension of the factory system to the manufacture of dairy products, the slaughter of meat, the canning of foods, and the manufacture of millinery, has had similar effects. This has increased the number of persons engaged in retailing, as well as the number of retail stores.

Finally, the development of branded, advertised, packaged commodities has also affected retailing. It has removed much

of the trouble of weighing and packaging,[12] has rendered it easier to keep the store neat and sanitary, has changed the selling problem by making sale by description—including the brand of the maker or merchant—take the place, many times, of the unaided efforts of the retailer. This development has also removed from the retailer a large amount of the ultimate responsibility for the quality of the goods delivered. Producers are more and more taking upon their own shoulders a large part of the responsibility for sales and quality.[13]

III

The developments which have just been summarized, together with the increased selling efforts of the manufacturer and the changed methods of wholesaling described in previous chapters, have had important influences on the operation of retail stores. These conditions have rendered the performance of some of the retail functions more difficult than they have been in the past; others are easier to perform.

Buying.—Perhaps the most difficult retail function is buying. This is to be expected. For the service of the retailer is to assemble goods for dispersion to the consumer at the latter's convenience. This usually means, also, at the momentary demand of the consumer. Consequently, the retailer is forced to estimate in advance what these demands will be, and to be prepared to fill them as exactly as he can. To do this, he must invest in stock, or arrange to receive credit from the supply houses. Then, when the goods are bought, they must be stored and prepared for sale. If products de-

[12] The use of packaged goods increased during the World War. See, for example, Harvard Bureau of Business Research, Bul. No. 13 (1919), *Management Problems in Retail Grocery Stores*, p. 31.

[13] These points are commented on at some length in Chap. XIX. By producers in this case is meant those whose name the trade connects with a product. A branded product, for example, may be sold under a manufacturer's brand or a jobber's brand, or it may be branded by the retailer.

teriorate, or if the demand ceases, or is not as brisk as anticipated the dealer will suffer loss. But if he does not have the products his trade calls for he is in danger of losing its patronage. Finally, after the goods are ordered and in his store, the merchant must often deliver them to his customers, to many of whom he may grant credit.

The size of stock which it is necessary to have on hand in order to do a given volume of business in most lines is now much less than it was in the past. Improvements in transportation and communication have brought about the better dissemination of market news, increased the use of traveling salesmen sent out by manufacturers and jobbers, and speeded up deliveries. The first helps the merchant to keep posted on market trends, and, with the last two, has made less essential the former semi-annual trip to inspect and buy goods in the wholesale market. The increasing competition, moreover, of manufacturers with jobbers, and of each of these classes among themselves, has led to a further speeding up of deliveries, as well as to a willingness on their part to deliver small orders at frequent intervals. The merchant can keep in constant touch with his sources of supply, and, with quick deliveries, he need not order in such large amounts as formerly. This not only reduces his financing and storing problems, but it reduces the risk of physical and market loss.

Selling Assistance from Manufacturers and Jobbers.—It has been shown that the retail merchant receives a great deal of assistance in selling from manufacturers and jobbers. A part of this is direct, as illustrated by some of the forms of dealer coöperation: window cards, electros, circulars mailed to his customers, and advice on selling, accounting, and other retail problems.[14] Some assistance is indirect, but often of great importance. The "national" advertising of manufacturers is the chief indirect item. In so far as the manufac-

[14] See P. T. Cherington, *The First Advertising Book,* Chap. IV; and Paul W. Ivey, "The Manufacturer's Marketing Problem," *Administration,* Vol. I (Mar., 1921), pp. 341–347.

turer's efforts are truly effective in linking the retailer with the demand created, the retailer's selling problem is by so much made easier. But to the extent that all competing dealers tend to link up with such efforts, it simply means that the force of competition is felt at other points.

But the dealer need not be a passive factor in selling. For he himself can influence the demand for his goods and services. Good service in performing the various functions of retailing is, for the small retailer, the most important means of doing this. And both large and small dealers utilize modern aggressive selling with great success. Advertising, suggestive arrangement of merchandise, well selected stocks, well performed services, attractive store surroundings, trained salesmen—all are used by aggressive retailers to create a demand for their products and their services.

Tendency Toward Better Service.—Under modern competitive conditions the tendency in retailing has been toward better and better service. The retailer's individual problem is to improve his service, but to do it at the lowest possible cost and to cover this cost through a large enough margin on a sufficient volume of sales. This is true of all service industries, but because of the very great emphasis which has been put on improvement in service in retailing and the effect this has had in increasing the cost of retailing goods, it is well to emphasize particularly this feature of the retail business. This demand for service is due in part to real consumer demand and in part to the limits within which retail competition has been confined by the encroachments of the manufacturer and the jobber upon parts of the retail field—particularly in the packaging, branding, and advertising previously mentioned.

Advertising and the Retailer.—Advertising tends to lower the cost of selling at retail. That this may result from the manufacturer's advertising has already been suggested. The advertising with which the consumer comes in contact in his daily paper, in magazines, on street cars, sign boards, dodgers,

and in the store, tends to lower selling cost because it does more cheaply sales work which would otherwise have to be done by personal solicitation.[15] Furthermore, when the consumer has decided, or has been influenced, in favor of certain goods, it takes far less time to make a sale, and individual sales may be larger in some cases because the goods are thus known. Advertising, moreover, brings new merchandise to the attention of consumers and informs them when and where goods they particularly desire are on sale. And dealers, through advertising are enabled to move slow stock from their shelves with greater speed. In all of these things the time of the clerk is saved, and many sales are made which would be too costly to close if reliance were placed on retail salesmen alone—sales which could, however, never be made without the exertion of sales effort.

New Problems.—But these modern developments are not all to the retailer's advantage. The increase in the number and variety of products has made buying and assembly more difficult.[16] The retailer must now choose from among great numbers of similar products the ones which his customers will demand and like, and which will net him a profitable margin over costs. The development of brands, labels, trade-marks, and especially of products nationally advertised has accentuated the problem. When there are several similar products which consumers ask for, and even insist on having, the stock of goods which the dealer must carry is greatly increased. For to carry a sufficient stock of five brands of shaving soap, tooth paste, or baking powder to meet all demands involves a much larger stock than is necessary to supply the same demand when but one or two brands need to be carried. The small margin on which some of these goods are sold is supposedly offset by the higher rate of turnover. But when it is

[15] See p. 16, note 8, and pp. 520–524.

[16] See Harvard Bureau of Business Research, Bul. No. 13, *Management Problems in Retail Grocery Stores*, pp. 32–33.

necessary to stock several competing products this advantage tends to be minimized.

Finally, some of the service developments of the department stores have had an important effect on retailing. In their efforts to enlarge their volume of business many stores try to imitate some of the services of these large establishments, and thus they greatly increase their costs. The luxurious fixtures, liberal grant of credit, return privileges, and elaborate delivery service of many small stores have proved an expense not warranted by their volume of business. The extreme to which these have been carried has evidently not met the approval of all consumers. For the mail order house, the cash-and-carry and the serve-self stores with their emphasis on a less elaborate service have made remarkable progress in recent years. So great have the inroads of these stores been that the older type of unit stores has had to look closely to its merchandising policies and methods—not only to improve its service but to reduce its costs.

Widespread Inefficiency.—There is ample room for improvement in retail methods. Inefficient salesmanship, poorly selected stocks, excessive inventories, and high costs are altogether too common among unit stores. Retailing is costly at best. For the small amounts in which goods are sold, the wide varieties in which they are demanded, and the physical and commercial deterioration to which consumption goods are often subject make this the most costly phase of our marketing system. Of the price paid by the final consumer for staple commodities, from 20 to 50 per cent, often more, is the margin which goes to cover the cost of retailing.[17] There are, however, wide differences in costs among retail stores in the same lines of business. This is in part due to the fact that the public will continue to patronize inefficient stores because they are convenient. It results also from the fact that prices have been rising for years, a condition which has tended to keep the

[17] For some typical margins see pp. 510, 515–518.

inefficient in the field longer than they could otherwise have remained.[18]

Retail Methods and Policies.—This discussion of some of the important conditions of modern retailing leads naturally to a statement of the methods and policies of modern retail merchandising. Competition is keen, efficient methods have been introduced, and new types of stores have been developed. Before discussing these conditions, however, the reader should be cautioned that not all of the tendencies just described, nor those about to be discussed, are necessarily found in all stores. Thus, many unit stores, department stores, chain stores, and mail order houses have their own brands and do not handle manufacturers' or jobbers' brands extensively;[19] many small stores refuse to give credit, or do not deliver; and the familiar cash-and-carry store and the self-service store appear to be distinct movements away from present methods in retail service.

A given store can compete on a basis of price, by selling at a lower price than do its competitors; it can handle quality merchandise and charge quality prices; or it may emphasize the nature of the service it renders in meeting the consumer's needs. Various modifications and combinations of these policies are always evident in the retail trade.

Elaboration of Service.—The point of first importance in describing merchandising policies is the elaboration of the retail service, through carrying a wide selection of commodities, and by means of such measures as the increased elegance and cleanliness of the store, prompt delivery service, and the granting of credit. It is important to point out the distinction between goods and services. An order of goods

[18] The assertions here made are not supported by definite data because they are now generally recognized as true by students of retailing. For statistical proof and for further discussion see the reports of the Bureaus of Business Research of Harvard and Northwestern Universities, and Nystrom, *The Economics of Retailing.*

[19] Many small stores—drug stores in particular—sell goods under their own brand.

which the consumer goes to the store to purchase, pays for, and carries to his home is a different commodity from that for which the order is taken by the delivery boy or over the telephone, sold on credit, and delivered at the customer's home. For the cost of order-taking, of carrying the customer's account, and of delivery must be added to the one, whereas these do not enter into the merchandising cost of the other.

An important aspect of retail service, which is another important cause for the high cost of retailing, is the ease with which the consumer can reach the store, and the certainty with which he can get exactly what he desires. The first accounts on the one hand for the innumerable small neighborhood stores, often inefficiently and hence expensively operated; and, with the second, it accounts for the tendency for stores to concentrate in "downtown" areas where very high rents must be paid.[20] The second accounts also for the wide variety of goods which modern stores carry. This variety of goods increases the buying costs of both wholesalers and retailers, increases the total investment in stocks, slows up the stock-turn, and makes selling more difficult.

Other Policies.—Three other policies of modern retailing which affect the consumer have become characteristic: one price to all, no solicitation in the store, and the privilege of returning goods which do not meet the consumer's fancy or which are not as they were represented to be. Fixing a price for a product and making it public to all prospective buyers has largely eliminated the higgling in the market so characteristic of early retailing. This policy has likewise gone far to remove the suspicion which the consumer formerly felt when buying. It is probable that no other policy could generally prevail to-day. With the multiplicity of goods appearing on the market neither the consumer nor the storekeeper and his clerks have the time, or even the knowledge of prices and

[20] Northwestern University Bureau of Business Research, *The Clothing Survey*, pp. 103, 106–137.

qualities, to "bargain" over the small purchases now common to the retail trade.

This same multiplicity of products makes it necessary for the consumer to look and consider before purchasing. And to make him more at ease in this and so to gain and keep his custom, the policy of no solicitation in the store has been generally adopted.[21] The privilege of returning unsatisfactory goods under reasonable restrictions has gone far to increase further the confidence of the consuming public in their retail dealers. Marshall Field's alleged dictum, "The customer is always right," defines what is a fairly settled policy among the better stores.[22]

Retail Brands.—A final policy of modern retailing is the introduction of retail brands, that is, of goods bearing the brand of the retailer rather than that of the manufacturer or wholesaler. This is a policy which is characteristic of department stores, mail order houses, and chain store systems. But it is by no means confined to these. Specialty stores in the larger cities, in particular, often adopt this sales policy. The classes of stores which have been mentioned are commonly doing business on a large scale, and they find it necessary to use every available means to call to their store and to maintain the patronage of a large clientele. By branding the merchandise they sell these retailers endeavor to influence consumers to buy their goods, which can be bought only of them. There are also price advantages to be gained from branding. Cut price selling by other stores is not felt so keenly when the

[21] This policy does not mean that efforts are not made to introduce skillful selling. This is being done more and more. But the sales effort is not carried to the extent of making the prospective buyer uncomfortable or resentful.

[22] This policy has been carried so far by some stores and abused by the public so freely that some merchants have endeavored to take advantage of the unsettled conditions of the past few years to place necessary restrictions on this practice.

merchant sells goods under his own trade-mark, since the goods are not directly comparable, so far as the consumer is able to judge, with similar goods sold in other stores. This same fact sometimes enables the retailer to maintain a wider margin on his branded merchandise than he could maintain on merchandise branded by wholesalers and manufacturers and sold in competing stores, as well as in his own.[23]

IV

Certain outstanding policies are evident in the organization and management of the modern store. In common with industry generally the tendency to large plants and large organizations has been felt in the retail business, outstanding examples of which are the department store, the mail order house, and the chain store system. And although the small store continues important and in many lines is apparently holding its own, the growth and the importance of the large retail merchandising establishment continue to increase.[24]

Stock-Turn.—Another important aspect of modern merchandising is the emphasis which is placed upon a rapid merchandise turnover, or stock-turn. The usual method of determining stock-turn is to divide the merchandise sold during a given period by the average stock on hand[25] during that

[23] Branding is further discussed on pp. 403–406 and in its relation to jobbing on pp. 142–146. See also Paul T. Cherington, *The Elements of Marketing* (1920), Chap. XIV; and H. B. Vanderblue, "The Marketing Function of Advertising," *Advertising and Selling*, Vol. XXIX (June 5, 1920), pp. 16–18.

[24] Figures do not appear to be available to make certain the exact relative status of these two classes of organizations now and at previous times.

[25] The average stock on hand is the average inventory. When an inventory is taken but once a year the average of the inventory at the end of the previous year and of the present year is commonly used. Since the stock is often lower than normal at inventory time this makes the turnover appear more rapid than it really is.

period, using cost figures in each case.[26] The resulting figure is the turnover for the period. Thus, if a store sells during a year merchandise which cost $360,000, and if it had on hand during the year an average stock of goods which cost $72,000 the merchandise turnover would be

$$\frac{360{,}000}{72{,}000} = 5 \text{ (turns per year).}^{27}$$

The rapidity of the stock-turn, or turnover, is an important barometer of good merchandising. It also serves as a means of comparison between departments, between different periods of time, between stores, and between lines of business. In it are seen the signs which point to the effectiveness or ineffectiveness of the buying plan, the price plan, and the selling plan. The business aim of the merchant is to so order his merchandising that large net profits will be made. This may result from a rapid stock-turn with a small margin of net profit on each turn, from a slower stock-turn with a wider margin of net profit, or it may result from a rapid turn, but accompanied, likewise, by a wide margin of net profit. These cases are developed in the three accompanying illustrations.

CASE I

Annual sales at cost	$100,000
Average stock at cost	10,000
Annual stock-turn	10 times
Net profit per turn	1% ($100)
Annual profit (10 turns)	$ 1,000

This is 10 per cent on the average investment in stock.

[26] Selling price figures may be used. The important thing is to use the same figures for both sales and average stock on hand. See Clifton H. Field, *Retail Buying* (1917), Chap. X.

[27] Turnover is sometimes figured by determining the number of days, on the average, which it takes to sell out the average stock on hand. If the sales are $360,000 per year this is at the rate of $1,000 per day (counting 360 days). An average inventory of $72,000 is, there-

Case II

Annual sales at cost	$100,000
Average stock at cost	20,000
Annual stock-turn	5 times
Net profit per turn	2% ($400)
Annual profit (5 turns)	$ 2,000

This, also, is 10 per cent on the average investment in stock.

Case III

Annual sales at cost	$100,000
Average stock at cost	10,000
Annual stock-turn	10 times
Net profit per turn	2% ($200)
Annual profit (10 turns)	$ 2,000

This is 20 per cent on the average investment in stock.

Stock-Turn and Prices.—If low prices which net extremely small margins will increase the stock-turn sufficiently to make the net annual return greater than it will be with higher prices and a larger margin but slower turnover, that policy should be adopted. The problem of the retailer is to determine the best relation between his profit margin on individual turns at particular prices and the rate of turnover which he obtains at these prices. In the staple lines, such as dry goods, groceries, meats, and hardware, the policy of a rapid turnover on small margins is largely favored. This tendency has resulted in part from the process of education carried on by manufacturers of advertised branded merchandise, who emphasize the rapid turnover possible and the small sales effort necessary to sell their goods. Perhaps a greater stimulus to rapid turnover has been the example of the cut price or low price stores who use the price appeal, and consequently to which a rapid

fore, seventy-two days' sales. This figure can be turned into an annual turnover rate by dividing 360 (days in a year) by 72 (days' sales, of the average stock) or five turns per annum.

turnover is an important criterion of success. In other lines, such as jewelry, high class furniture, and fancy goods, the turnover is usually much slower; and it is not sufficiently stimulated by low prices to warrant dealers in keeping their margins at a low point. In such cases a proper purchase plan and high grade sales efforts are of greater relative importance.

Buying and Sales Effort.—The importance of the price policy in its relation to turnover may easily be over-emphasized. Of perhaps greater importance is the skill with which buying is done and the success of the sales campaign. Nothing is so likely to slow up turnover as the purchase of goods in larger quantities than the trade demands, and the purchase of goods which do not sell. Yet both causes for a slow stock-turn are constantly in operation. Quantity prices and the sales efforts of supply houses constantly lead to overstocking. And the excessive variety of goods offered for sale, and pushed by the skillful merchandising of manufacturers, leads also to the purchase of excess stock and, as well, to the frequent purchase of stock which cannot be moved. Good buying, then, is essential both to meeting the demands of consumers and to keeping down the average inventory in relation to sales. Since the average inventory is the denominator in the turnover fraction it is evident that good buying is essential to a rapid stock-turn. But the numerator of the turnover fraction is the annual volume of sales, and success in retailing depends on moving the goods from the shelves once they are bought. This starts with good buying, but successful selling may mean the difference between a small and a high turnover, and a large volume of business.

Further Consideration of Stock-Turn.—There are also specific advantages which accrue from a rapid turnover, and, conversely, disadvantages which arise from a slow turnover. With a rapid turnover the investment necessary to do a given volume of business is reduced. Thus in Case I an investment of $10,000 in stock is enough to do the same volume of business as an investment of $20,000 in Case II. There

is likewise a saving of interest on the investment in stock when the inventory is small. Furthermore, the risks and losses of carrying a large inventory are reduced. For there is less danger of physical deterioration, a smaller number of goods will be left to dispose of at marked-down prices at the end of a season or following a change of styles, and shelf-worn goods will be less in evidence. Stocks are more likely to be fresh and up-to-date, and they will occupy less storage space.[28]

Finally, when a rapid stock-turn is brought about with an increase in the total volume of business, economies in certain types of expense will result, which unless offset by increases in others will reduce the net unit cost of doing business. The expenses which tend to be reduced are rent, interest, heat, light, insurance, etc. But the more rapid turnover and the increased volume of business may have been made possible by an increase in the buying and selling expense, and so cause an increase in the total expense for buying, clerk hire, advertising, express and delivery costs, etc. The net result on unit expense will depend on whether the first costs reduce more rapidly than the latter increase.[29]

Advertising and Departmentization.—Closely related to the question of turnover is the development of retail advertising and departmentizing. Advertising in particular is utilized as a means of stimulating not only the total business, but also sales in new lines, and in those that are moving slowly. The large stores can utilize advertising—particularly newspaper advertising—to greater advantage than small stores, for a given expenditure will influence more people. But many retail stores, on the other hand, thrive as small stores without

[28] A good discussion of turnover and of the need for accurate stock control will be found in *Merchandise Turnover and Stock Control* (1921), a pamphlet published by the Domestic Distribution Department of the Chamber of Commerce of the United States, Alvin E. Dodd, Manager, Washington, D. C.

[29] See W. H. Ingersoll, "How Distribution Costs Can Be Lowered," *Marketing,* March, 1920; also Northwestern University Bureau of Business Research, *The Clothing Survey* (1921), pp. 464–92.

the need for expensive advertising to stimulate demand. In fact, so true is this that large stores are found to spend relatively more for advertising than do small stores.[30] Inasmuch as personal solicitation either in the store or without is seldom resorted to for the purpose of demand creation, retail establishments must depend on the nature of their service, coupled with skilled suggestion, and supplemented by the advertising campaign, to stimulate their business.

The orderly arrangement of stock according to the nature of the product or of selling conditions was an early development in modern merchandising, and if it did not lead to modern departmentizing, at least it is the principle on which departmentizing is based. As retail establishments have grown in size and as the variety of goods dealt in has increased, it has become increasingly difficult for the proprietor to control the great mass of details inherent in merchandising. There comes a rather definite limit to the size of establishment which can be administered, and to the variety of goods which can be sold under the immediate supervision of the proprietor. This logically leads to the division of the business into departments, according to classes of goods or the nature of the administrative work.

Goods are departmentized by classes or relations in use so that the proprietor can keep close track of the stocks in each, and of their rate of turnover and profit. He is thus enabled to know where the weak points of his system are, as well as the strong.[31] When the business becomes large enough, department managers are introduced to take charge of the work in a department; generally to oversee the buying, selling, pricing, and care of the stock. They are usually held re-

[30] Northwestern University Bureau of Business Research, *op. cit.*, p. 291.

[31] Turnover figures for a whole store are seldom of value to the management. To have a real effect on buying, selling, or pricing policies turnover must be obtained by departments, or even better by individual products.

sponsible for results in their department. In the service departments it is also found advisable to arrange the work by departments, although this is less likely to be necessary in smaller stores.

CHAPTER XII

LARGE SCALE RETAILING

I

Advantages of Large Scale Retailing Summarized.—The following advantages inhere in greater or less degree in all large retail establishments; that is, in department stores, mail order houses, and chain stores:[1]

1. Specialization of men and departments.
2. Economy in the expense for highly skilled specialists, for overhead charges, and advertising.
3. Rapid stock-turns.
4. A stock consisting of a wide variety of timely merchandise.
5. Special service to customers.
6. Superior buying advantages.
7. Economies of integration.

Specialization of Men and Departments.—Certain advantages of specialization common to all large scale operation are found in large scale retailing. The large establishment can have a special accounting department, delivery department, buying department, school for salesmen, adjustment bureau, credit department, financial officers; and finally it is able to control its merchandise operations on a departmental basis, and the work of each department can be divided among individuals according to the class of goods handled or

[1] Alfred Marshall shows that the pioneer work of modern large scale retailing—"massive retail trade"—was done by the British workingmen in their coöperative enterprises. Alfred Marshall, *Industry and Trade* (1919), pp. 289–295.

the work performed.[2] Because the volume of work of each kind is large the personnel becomes skilled and the time of each individual can be fully utilized in the field of his special skill.[3] In this way it becomes possible for the concern to employ the talents and the time of each member of its staff to the best advantage. Furthermore, with so many employed, the large establishment can afford to devote time and effort to the training of its staff, and thus encourage and develop each member to a greater usefulness. Finally, the large volume of its business enables it to pay enough to keep experts in its employ.[4]

Economy in Overhead Expense.—Aside from the economy that arises from utilizing the full time of highly paid experts and of a specialized staff in the fields in which they are most proficient, other economies in overhead expense are possible. The expense of the plant, including warehouses, rent, heating, lighting, delivery, is spread over a large volume of business, and so tends to be less per unit of sales than in smaller establishments. Unfortunately, the increase in the *kinds* of overhead charges which such stores must bear tends to offset this advantage, and, in addition, some sorts of overhead expense are increased.[5] Finally, the expense for advertising is likely to be less per unit of sales than it is when competing small establishments advertise. The department store advertising a sale of silk goods will draw customers who will also buy hosiery, hardware, and other products, whereas the specialty or unit store handling but one line of products cannot expect such widespread results. The mail order house through its

[2] See pp. 234–236.

[3] This advantage is not sure to result, see p. 222. For a discussion of the general advantages of specialization, see Alfred Marshall, *op. cit.*, Part I, Chap. VIII, and pp. 233–234, 244–245, 508–509, 592.

[4] The general run of department store buyers receive from $3,000 to $12,000. In rare instances much larger salaries are paid. An article by Edward M. Wooley discussing these salaries as they were in 1914 appeared in *Printers' Ink*, Aug. 6, 1914, pp. 8 ff.

[5] See pp. 216–218.

advertisement in the weekly paper reaches prospects to whom it sends its catalogue. This catalogue, in the case of the larger establishments, advertises thousands of articles. The single advertisement for the chain store system of a city may contain the advertisement of the goods of all the stores in the system.[6]

Rapid Turnover.—A rapid turnover of stock is an aim of all good merchandising. It is not peculiar to large scale operations. But from the data available it appears that if large establishments do not have a more rapid turnover than all competing shops, at least they are far above the average of the smaller stores.[7] From the meagre data at hand it is commonly assumed that department stores turn their stock more rapidly than do general stores, the nearest comparison possible. Individual departments probably do not turn their stocks so rapidly as do the better unit stores in competing lines. Chain stores apparently turn their stock much more rapidly than do competing unit stores. Figures are not available regarding mail order establishments, but it is usually assumed that the general statement will apply to them.

The reasons for this rapid stock-turn of large establishments are not far to seek. In the first place, the expert personnel which they can afford to train or hire enables them to buy with greater regard for market demands; and they can effectively create demand when that is essential. Quantity prices and large cash resources give them advantages in the cost of merchandise. To meet the demand for variety and to carry numerous brands of similar goods requires but a relatively small stock of goods in lines for which there is small demand. Being small in relation to the total volume of business, such stocks do not hold back the turnover record

[6] But many unit stores do not use the advertising methods large stores use and, consequently, have little or no advertising expense. The need for advertising is also sometimes considered a disadvantage of large stores. See p. 217, note 16, and pp. 221–222.

[7] Nystrom gives some figures on turnover in his *Economics of Retailing* (2d ed., 1919), pp. 235–236.

as they would in smaller stores. Furthermore, large stores are better able than small stores to sell goods under their own brands. This tends to overcome the necessity for carrying competing brands. Finally, the possibility of changing goods from main floors to the basement in department stores, from one store to another in chain stores, and the very wide geographical area to which the mail order house appeals, enables each to try out a slow selling article in more than one market.

Special Services — Adequate Stock.—The excellent service which such stores offer is another advantage. For although good service is not monopolized by large establishments, it is at least true that they specialize in this field and often set the pace. Service is an essential part of their merchandising plan.[8] If such stores did not give excellent service they could not easily hold trade in competition with unit stores.[9] The furnishing of a wide variety of fresh and seasonable goods is one aspect of the service offered by large stores. To furnish just what the customer wants at all times is almost impossible for the small general store, and for any but the largest unit stores. This makes it necessary for the consumer to purchase from many unit stores. It is a great trading asset of the large store to be able to supply this variety.[10]

[8] A recent newspaper advertisement of Marshall Field and Company is headed "The Store of Service," and the services described are: general information bureau, personal service bureau, general reading, writing and rest rooms for men and women, women's silence room, check rooms, theatre ticket office, traveler's checks bureau, lost-and-found bureau, telegraph office, medical room, postal substation, tea rooms, taxicab station, party and favor bureau, the gift secretary, interior decorating advisory service, elevator service, special wrapping of gifts, model rooms, costume room, custom apparel sections, fur storage, window displays, delivery service, "other features of service," the basement salesroom, juvenile floor (including a playroom for children), the store for men, and finally, "service in merchandise" and "service in equipment and conduct."

[9] See pp. 214–215.

[10] The shopping trade of the city has been largely absorbed by the department store, and for country trade, by the mail order

The examination and return privilege of department stores and mail order houses should also be classed here, as should the rest rooms, fine surroundings, and delivery service of the department stores, and, of an opposite nature, the cash-and-carry "privilege" offered by chain stores with the resulting reductions in prices. In times of high prices this chance to choose between price and service is a very real privilege to persons wishing to reduce their cost of living and willing to relinquish some services to do so. In fact, it is sometimes said that the sale of goods stripped of many of the ordinary services of department and specialty stores is the best kind of service that can be offered by mail order houses and chain stores to their customers.

Buying Power.—The superior buying advantages of large organizations are often due in part to the control of successive marketing processes within the establishment. But passing over this feature for the present, there appear to be certain advantages in buying inherent in the large retail establishment. The specialist features here as elsewhere. The large stores can have buyers who devote their entire time to buying, frequently in a very narrow field. They are in touch with the needs of the selling department,[11] with a thorough knowledge of the goods to be purchased, as well as of qualities, styles, values, costs, and market conditions. Smaller dealers cannot afford to pay the large salaries needed to get help of this class. It is more than likely that the proprietor himself does the buying, in addition to his other duties, depending upon his clerks to assist where his own knowledge fails.

The buyers for large retail establishments are personally well equipped and in addition they are armed with weapons

house. Investigation by *The Chicago Tribune* shows that in certain sections of the city practically no shopping goods are bought in local stores.—*The Book of Facts, 1921*. See also C. C. Parlin, *The Merchandising of Textiles*, p. 6.

[11] The buyer is usually in charge of sales for his department in the department store, and to a degree in the mail order house.

which the small store can seldom duplicate. In the first place, the very volume of purchases is an opening wedge by which they can get the lowest discounts offered for quantity purchases, frequently even an "inside" discount. Volume further assists by making it more possible to utilize and follow statistical averages which grow out of past experience, such as those dealing with seasons, sizes, qualities, and similar data which will be of use to the buyer in determining his policy.[12] Coupled with their large orders is the ability to pay cash. Large stores are usually in a position to finance themselves. They do not depend on manufacturers or middlemen. Even when such firms borrow money with which to pay cash for current needs, they can get terms better from banks and investors than those offered to their smaller competitors. Many of the smaller stores are forced to depend very largely upon the accommodation of jobbers and manufacturers.[13] Smaller stores, consequently, through higher prices, or directly, pay an interest rate on the credit they receive which is much higher than that paid by the larger firms. The money which a department store can borrow on its short time notes at from 4½ to 6 or 7 per cent may result in a discount on the product it buys of from 10 to 20 per cent or even more—reckoned on an annual basis. Manufacturers in particular are willing to give very large discounts in order to turn their stock into

[12] The three most striking features of the large department stores' buying methods which differentiate them from the regular retail outlet of former days are (1) the stock plan, (2) the seasonal calendar, and (3) the development of "sources." See Cherington, *The Wool Industry*, pp. 228–234, also Clifton C. Field, *Retail Buying*, Chap. IV.

[13] "It is the opinion of many authorities closely connected with the department store system that it is a common error to think that the strength of the department store is based on the advantages it offers the purchasing public, for those advantages are merely effects, not causes. The fundamental strength of the department store lies in the advantages it offers to those from whom it buys goods and from whom it buys money to buy goods. It sells well, and is able to give elaborate service to its customers, because it buys well."—Wm. Cooke Daniels, *The Department Store System* (1900).

immediate cash. Because their purchases are so large and so important to manufacturers, these large stores can get better prices than do small competing stores; sometimes they pay lower prices than do the jobbers themselves.[14]

The purchase of goods at "inside" prices is not looked upon with favor by many merchants because it smacks of unfair competition and monopoly, but it appears, nevertheless, to be a factor in the market and is another aid to the large buyer who uses it. Inside prices and similar practices take some of the following forms. The buyer may be given larger discounts for quantity buying than are usually offered to the trade. He is given these for a variety of reasons: to get rid of a surplus stock, to gain his future trade, or because of the large volume which he agrees to take at the lowered price. Extra services or additional goods may be "thrown in," or the bill may be dated several weeks or months ahead, the usual terms applying from that date instead of from the actual date of sale or delivery. Finally, these large buyers, in constant touch with the market, can often pick up bargains from manufacturers who have a surplus, or from jobbers or importers who are overstocked, or even the stocks of retail stores which are in difficulty. Such articles may be of standard quality or they may be articles which will offer good material for a sale or as leaders.

Superior Buying Ability in Choosing Stock.—But the purchase of goods at lowered prices is not the only advantage which the large retailer has in the buying field. Price is but one aspect of a sale; the customer also demands quality, style, variety, "newness"; and in these, also, the large firm usually

[14] The justification for quantity prices has been outlined as follows: unit manufacturing and distributing costs are less on large orders and the overhead charges on each transaction are less, large buyers ordinarily have higher credit, cut prices are an incentive to buyers to order in larger quantities. Some of the arguments for and against the policy will be found in *System,* May, 1919, pp. 850 ff.; *Printers' Ink,* June 28, 1917, pp. 88–92, Aug. 17, 1916, pp. 114 ff., Dec. 20, 1917, pp. 88–91.

has an advantage. Its buyers are constantly in touch with the market, finding out the latest tendencies, the newest articles, even seeking products to meet as yet unfelt consumer desires which they have sensed. Some large stores have buyers, or agents, in important foreign centers, as well as in the important domestic markets, who are buying and gaining information of the latest styles and of new products.

Integration.—A final advantage of large scale retailing is the integration of retailing with jobbing and even with manufacturing. When a department store, a mail order house, or a chain system buys directly from the producer it is doing the work which the jobber, and even the importer, formerly performed for it; that is, storing, financing, assembling. Not only is this true, but frequently, at least in the case of department stores, the result is that the store goes into the wholesale business. This may be done either because of the profits to be made or because it is thereby enabled to sell a larger volume of products, and to receive jobbing, or greater than jobbing, discounts. Furthermore, by entering wholesaling, the store gets into closer touch with the ultimate sources of the supply of merchandise.

The central purchasing department of a chain store system amounts to a typical jobbing organization, performing for the separate links in the chain the identical function which wholesale houses perform for their competitors.[15] But large retail firms do more than their own jobbing; they are often engaged to some extent in manufacture and even in agriculture. One great string of restaurants has its own dairy farm, and mail order houses and department stores frequently own or control plants manufacturing some of the products they sell.

The Extent of these Advantages Varies as Between Types.—The extent to which these advantages apply varies

[15] In the case of coöperative jobbing as carried on by such retail coöperative organizations as the American Drug Syndicate, United Drug Company (Rexall Stores), and the Gerard Grocery Company of Philadelphia, a separate jobbing organization is controlled by the retailers.

widely as between the different types of large retail organizations. Some of them are not exclusive advantages of large retailing, but are rather the marks of skilled merchandising. The integration of jobbing with retailing and the advantages in buying are characteristic of all types of large retail organizations. They serve also as a chief contrast with small retailing. In the case of the mail order house and the chain store and of the low-price department store, the price advantage which results is of prime importance, whereas the advantage in keeping in touch with the latest products and styles and fashions is of greater importance to the department stores which sell to the more exclusive trade.

The advantages of specialization by departments and the economical use of men and equipment are likewise common to each type. It arises, however, from their very nature that more departments are necessary in department stores and in general mail order houses than can be used by a chain of unit stores selling in a single field. Rapid turnover is particularly stressed by the chain stores, especially when they sell on a price basis. But it is, of course, important with the others. Necessary variety, freshness, and stylishness of merchandise are perhaps equally important to chain stores and mail order houses, but they are of the greatest importance to department stores.

II

Disadvantages.—The disadvantages of large scale retailing can be more briefly stated. But they should not for that reason be under-estimated, since very distinct difficulties confront these large organizations. The first of these is the great cost of doing business. In order to carry out their plans such stores must create a very large demand for their services. Department stores and mail order houses particularly must draw their clientele from a wide territory separated by considerable distance from the establishment itself and hence

situated in markets normally tributary to other dealers.[16] For the department store this necessitates an enormous expenditure for advertising and service, with which to create a sufficient clientele. To the mail order house it necessitates large expense for correspondence and advertising, particularly for the preparation, printing, and mailing of expensive catalogues. Another heavy expense of the mail order house is for the transportation of shipments, or the competitive disadvantage of making clients pay delivery costs. A similar cost to the department store is the delivery expense.[17]

Again, large organizations must depend upon hired employees. These are proverbially less efficient ~~in their work,~~ less cautious in management, less courteous and less effective in selling, than are the proprietors of smaller shops. Not being in immediate contact with those most interested in the welfare of the organization, the incentive to efficient service is peculiarly lacking. Careful training, high salaries, and expensive systems of accounting, supervision, and control seem to be the only means of offsetting this disadvantage.

Finally, there is lacking in the large store that friendly feeling which usually exists between the proprietor of the small store and his customers. The general absence of a feeling of friendliness towards large corporations undoubtedly has

[16] The following suggestive data purport to show the relative "cost of getting trade," which includes normal kinds of retail advertising costs, such as letters, catalogues, window decorating, newspaper space (as shown in an article by Wheeler Sammons, "The Cost of Getting Trade," in *System*, Vol. XXV [June, 1914], p. 585).

Groceries	.83 per cent	Drugs	1.76 per cent
Hardware	1.17 " "	Clothing	2.16 " "
Vehicles and Implements	1.22 " "	Furniture	2.72 " "
Variety Goods	1.52 " "	Jewelry	2.85 " "
Shoes	1.65 " "	*Department Stores*	4.01 " "
Dry Goods	1.67 " "	*Mail Order House*	7.21 " "

[17] Figures compiled by the Bureau of Research and Information of the National Retail Dry Goods Association show delivery costs ranging from nine to twenty cents per package in 1919.

its effect in causing customers to prefer small dealers or to impose on the large firm if they do patronize it. It is improbable that a small store should have purchases returned amounting to 30 per cent of charge sales, a condition found to exist in a large eastern store in 1917, or even 12 to 20 per cent, a more common situation with Boston and New York department stores.[18]

In the remainder of the chapter certain individual characteristics of the department store, mail order house, and chain store will be emphasized.

III

A. The Department Store.—The department store is a retail establishment which sells a variety of goods, and in which the merchandise is divided into classes—each one of which is handled in a department which is distinct as to management and location within the store, and which is carried in the accounts as a separate entity. Almost unknown only a half century ago the origin of the department store is, nevertheless, uncertain.[19] The most probable explanation is that it was a natural outgrowth from the dry goods store. It is known that many recent establishments started in this way.

[18] "In few of the large stores were returns less than 12 per cent of gross sales, while 15–20 per cent was not uncommon."—*Economy in Retail Service*, 1918, published by the Commercial Economy Board of the Council of National Defense, p. 7. The Retail Research Association, 225 Fifth Avenue, New York, found returns in large department stores in 1921 averaged about 10 per cent of sales, and the National Retail Dry Goods Association, 200 Fifth Avenue, New York, in an extensive investigation made in 1921, found that returns averaged 8 per cent of sales. The detailed figures for 1920 are: average per cent of returns to total sales, 7.8 per cent, to charge sales 13.5 per cent, to C. O. D. sales 13.45 per cent.

[19] Alfred Marshall believes that the first true department stores arose in France, the "Bon Marché" and the "Louvre" established about 1852. These in turn, he believes, received their inspiration from English coöperative experience. But the greatest development has occurred in the United States. See Alfred Marshall, *Industry and Trade*, pp. 295–6.

As the margin on textiles became less and less with increasing competition in the retail field, the owners of dry goods stores naturally turned to women's factory-made clothing, notions, and other articles related to their trade which the development of manufactures had brought on the market. From each new article it was but a step to the next, until convenience in handling and the necessities of management must have led to departmentization. Then, with departmentization established and the idea in mind, extension into other fields than dry goods and related products naturally followed. To-day the department store tends to supply all the needs of its customers. In 1913 there were 1,140 department stores in this country, the average annual sales of each amounting to more than $200,000.[20] Several of these were doing a business of over $10,000,000 and one had a business of $35,000,000. In 1920 Marshall Field and Company did a $65,000,000 business, Carson Pirie Scott and Company did a $50,000,000 business and nine other stores in New York, Philadelphia, and Chicago are reported as having done a business of $20,000,000 or more.

Advantages: Conveniences to Shoppers.—Compared with the unit store, its most direct competitor, the department store offers important conveniences to its customers. It is preëminently the shopping store. In fact it has drawn to itself so much of the shopping trade—trade which involves the careful comparison of style, quality, and price—that smaller competing dry goods stores, in particular, have almost abandoned that trade and have confined themselves to selling convenience goods. With its many lines under one roof the shopper can complete her purchases without leaving the store. It is located in a central retail district, often in a beautiful structure, where the shopper trades among pleasant surroundings. Among the conveniences within the store itself are rest rooms, lunch rooms, tea rooms, and writing rooms—all designed to

[20] C. C. Parlin, *The Merchandising of Textiles* (The National Wholesale Dry Goods Association, 1913), p. 26.

induce the customer to come into the store and remain to complete the shopping. Some of these services are free and those for which charges are made, such as the lunch service, are not believed to be important profit-making ventures. Other services not confined to department stores, but which have been developed by them to a high degree, are deliveries, the grant of credit and with it the convenience of having all purchases on one bill, and the privilege of trial and return of goods.

The mere size of the department store has an effect upon the buying public.[21] Big stores have usually a reputation for reliability. The store building may even be said to serve as a symbol about which the firm's good will can be built.

But even with these advantages and the other advantages of large scale retailing previously mentioned to assist it, the department store has by no means an easy time and its smaller competitors, particularly the city specialty shops, continue to thrive.

High Expense.—The cost of operation is very large. It has been estimated from time to time to range from 24 to 31 per cent of sales.[22] This is higher than similar estimates for either chain stores or mail order houses. Comparisons with competing unit stores, although more pertinent, are difficult to make. The general statement that department store costs are higher, however, seems warranted from the facts available. Rents, advertising, and delivery expenses are usu-

[21] "Big business appeals to the imagination of the people of the twentieth century, especially to the people of the middle and lower classes. The big store suggests class and distinction. To trade there to a certain extent confers distinction. The big store's automobile delivery truck calling at one's residence heightens this effect."—Nystrom, *Economics of Retailing* (2d ed., 1919), p. 261.

[22] The National Retail Research Association estimates it to be 25 to 30 per cent of sales, the National Retail Dry Goods Association, 28 to 31 per cent, and an investigation of 266 department stores recently made by the Harvard Bureau of Business Research finds their average expense is 27.8 per cent of sales, and net profit 1.8 per cent.

ally assumed to be higher for department stores than for competing unit stores. But convincing data are yet to be secured, for although these items are individually large, the amounts are divided over very large volumes of trade, which tends to lessen the unit charge. And if the volume of business resulting from the preferred location, advertising, and delivery service is great enough, the unit cost [23] will become very low. Furthermore, even large unit costs are not a positive disadvantage if they are offset by, or are the means of securing, a sufficiently rapid turnover.

It is popularly assumed that the high rentals paid in the preferred locations necessitate a higher unit cost for rent. Stores otherwise located sometimes make much of this in their advertising. The explanation of rent to which economists generally adhere would indicate, on the other hand, that the larger volume of business done in such locations offsets the increased rent. Marshall even goes so far as to state that there is a saving to the large store "especially in ground rent: for a single first-rate frontage on a good thoroughfare serves as an introduction to many acres of flooring. . . ." [24] Data gathered concerning men's retail clothing stores seem to show that rents are less per $100 of sales in the better locations; at least, less for large stores than for small.[25] From a competitive point of view one other point has an important bearing here. Many department stores own their ground space and so pay no ground rent to outside parties. If an increased rental is charged when such land increases in value, it is simply an accounting expense. It does not have to be

[23] That is, costs per unit of sales—usually expressed as a certain per cent per dollar of sales.

[24] Alfred Marshall, *Industry and Trade*, p. 297. On the other hand, Nystrom introduces an interesting theory to the effect that future values are discounted and a part of the profit of superior management is taken by the landlord. See his *Economics of Retailing*, Chap. XI.

[25] Northwestern University Bureau of Business Research, *The Clothing Survey*, p. 121.

paid. This is an important competitive advantage in case of need.

There is less reason to doubt that advertising and delivery are relatively high expenses for department stores. The creation of demand among prospects in outlying districts involves an enormous expense for advertising, and the delivery of goods to such customers is likewise costly.[26] Even here comparative data are not convincing. The department store is competing with many kinds of stores in varying locations, and the data gathered so far are relatively meagre.[27]

Departmentization itself, while bringing economy in the time of some employees, causes waste in the time of others. Thus, there are certain to be slack times in the work of many clerks and helpers in the various departments, whereas these same employees in a unit shop, when not selling one thing could be selling another or could be performing other necessary duties. The delivery boy or the proprietor's wife help sell when there is a rush, or the clerk helps to deliver, take inventory, and keep the books. To offset this, to what degree it is impossible to determine, some employees in the larger stores are trained to work in several departments as need arises.

Personnel Problems.—Again, as this type of establishment caters to the shopping trade,[28] it is very susceptible to losses

[26] Competing unit stores usually deliver in a smaller area; if they catered to customers in as wide a territory as does the department store their delivery expense per sale would, of course, be greater because, whereas they confine their service to one line of goods, the department store sells and delivers many lines.

[27] The Harvard University Bureau of Business Research has announced an investigation of department stores. The fact that savings in advertising expense are sometimes given as an *advantage* of department stores shows how meagre and inconclusive the data are. See pp. 209–210.

[28] "Woman's purchases are of two distinct classes. . . . These two classes we call 'convenience goods' and 'shopping lines.' Convenience goods comprise notions, cottons under 15¢ a yard, stockings for the children, and in general, the lower end of woman's purchases. An inventory of a suburban dry goods shop will furnish a complete list of

through poor salesmanship. This difficulty is greater with the department store than it is with the chain store, which caters more largely to convenience goods, or the mail order house, in which the personality of the employees is not in evidence. The importance of a well-trained sales force is now recognized. And the recognition of this need has forced the payment of better wages and the development of systems for training and arousing the initiative of salespeople. But hired salespeople, even with the best of training and the greatest of incentives, seldom have the interest, tact, and courtesy of the unit store owner or of his clerks—who are working always under his watchful eye and with a more direct personal knowledge of the firm itself and a more personal interest in its success.

Finally, the very size of the business and the diversity of goods it carries and of services it performs make it peculiarly liable to excessive expense and to unforeseen losses. To counteract these risks it is necessary to build up expensive store systems for supervision, accounting, statistical service, and the training of employees. A "system" is frequently necessary in order to keep track of and to guide activities which in smaller stores and stores with less diverse activities are under the immediate attention of the owner of the store.

B. The Large Mail Order House.—The great mail order

convenience goods. These lines are bought under the same influences that affect men: (1) at a convenient store, or (2) by impulse, or (3) at an accustomed place, or (4) by brand. There is little or no comparison of values.

"Shopping lines in general comprise the upper end of woman's purchases—cloaks and suits, carpets, millinery, the better grades of hosiery and underwear, and all those articles which a woman records on her mental shopping tablet (which never forgets), and of which she defers the purchase until a trip to her shopping center. In these lines a woman does want to compare values. She wants to go to one store, then to a second, then to a third, and after having seen three stocks, to make her choice, by comparing quality, price and style."—C. C. Parlin, *Merchandising of Textiles*, pp. 5–6.

house is a unique American institution. Although business has been done at retail through the mails perhaps since the establishment of the post, this particular development dates only from the establishment of Montgomery Ward and Company in 1872.[29] Although the mail order business is discussed here as a type of large scale retailing, its method is not confined to large firms nor to retailing. Some jobbing houses sell entirely or in large part by mail, and most jobbing houses stimulate mail orders between calls of their salesmen. Many department stores carry on a more or less extensive, although not always successful and profitable, mail order business, as do many specialty stores and some chains.[30] Many manufacturers attempt to sell by mail to the ultimate consumers either all or a part of their output, and finally, much international trade is carried on through mail order methods.

Nystrom estimates that perhaps a billion dollar retail business is carried on annually through the mails.[31] The business of the two great Chicago houses (Sears, Roebuck & Company and Montgomery Ward & Company) alone amounted to approximately $360,000,000 in 1920. The larger of these, Sears, Roebuck & Company, had 8,000,000 names on its mailing list. Probably something over 10,000,000 people in the United States are regular customers of these two houses.[32]

[29] M. T. Copeland in his *The Cotton Manufacturing Industry of the United States,* in speaking of the cloth merchants of the nineteenth century states (p. 194) that "they had agents in various cities to whom they consigned goods, and they also solicited orders by post through advertisements in the newspapers of the different cities." Although such sales were probably at wholesale it shows that the method is not new.

[30] See *Printers' Ink,* May 20, 1915, p. 70, "Kresge Chain Reaching Out for Business by Mail." Many retail store managers who attack the great mail order houses for their methods are themselves extending their business through the mails to the customers of smaller stores in near-by towns.

[31] Nystrom, *Economics of Retailing* (2d ed., 1919), p. 291.

[32] "There are over 2,500 mail-order houses in all in this country. Of this number 850 are rated at over $100,000." *Ibid.,* p. 290.

Many of these order most of their products from local stores, but the figures given are nevertheless indicative of the importance of this type of business.

Its Rise.—The reasons for the inception of the mail order business in this country have been well summarized as arising from

"the independence and lack of community spirit of the American countryman due largely to his isolated manner of living, the general circulation of periodical literature among all classes of people, the increased earning power of many classes, the rising standards of living, the backwardness of many small-town merchants, the power of mail-order advertising to create demands for mail-order house goods, and the cheaper price argument."[33]

Methods.—Most of the methods of the large mail order house are similar to the methods of other large retail organizations. They are in particular similar to department store methods. But whereas the latter must draw customers to the store and depend upon display, advertising, and personal salesmanship to create demand, the mail order house depends upon advertising alone. The sole method of demand creation is through advertising[34] and, of course, the satisfaction derived from the goods and services it sells. Mail order advertising consists of newspaper and magazine advertisements, catalogues, circulars, and letters. The advertisements and letters of the better houses are unusually well composed, truthful, and courteous as well as convincing in their appeal. Many retail stores could learn useful lessons in accurate and illuminating description of merchandise, and in prompt, courteous treatment of customers, from the advertising and correspondence of the large mail order houses.

Although lacking the personal appeal and the element of

[33] Nystrom, *op. cit.*, p. 295.

[34] That is, the mail order business depends on advertising, but some mail order houses have departments which sell by ordinary retail methods. Montgomery Ward & Company and Harris Brothers Company, for example, have retail sales rooms in their Chicago plants.

good will inhering in the ordinary retail store, the catalogue of the mail order house offers, nevertheless, many advantages in selling. Aside from the features previously discussed, it is available for immediate reference, and can be perused at leisure. Few people are willing to take the time during business hours to go over the entire stock of the retailer's store, and few retailers would allow them to do so, but the goods of the mail order house are always at hand through their catalogue for what approximates just such inspection.

Cash Sales.—Another feature, which, although not confined to mail order business, has until recently been an almost universal characteristic of their trade, is the sale of goods for cash. In recent years this policy has been modified by some houses in those sales in which large amounts are spent for a single item, such as a piano or a cream separator. It was found that these goods would not sell without this arrangement, the original investment being too great for the average customer.[35] Another important policy is that which guarantees the goods to give satisfaction. This, again, is not confined to the mail order business, but because of the distance of customers from the house, and the demand for cash with orders, it is undoubtedly an essential element in getting and retaining business. Many a customer has been kept and many a new one made through the policy of some of these houses in allowing goods to be returned at their own expense and in cheerfully refunding the purchase price of the article.

Two Greatest Advantages.—The two greatest advantages of the mail order house over its strongest competitor—the country store—are (1) the great variety of goods carried, and (2) superior buying. The country store finds it impossible to carry the different kinds of goods or the varieties and styles

[35] Sears, Roebuck & Company's annual report for 1920 showed a little over $47,000,000 in accounts receivable, out of a total business of over $230,000,000. These credits were mainly for the sale of home building materials, phonographs, and encyclopedias sold on a time payment basis.

and sizes which consumers demand. Although such goods can be ordered on special request many dealers are not accommodating in this regard, and customers commonly prefer to order for themselves rather than allow the dealer to order for them.[36] The mail order house not only carries the goods usually demanded but through its advertising creates demand for other merchandise.

Superior buying makes possible a properly assorted stock and assures that low prices will be paid for goods bought. The reasons for this superior buying are the same as those which inhere in all large retail organizations. But they are probably realized in greater degree, for the volume of business done by the large mail order house is greater than that of department stores or chain stores.[37] The advantage resulting from the great buying power of the firm is perhaps the chief factor in the low price appeal which such organizations can make. That some articles are sold by the mail order houses at lower prices than competing retail organizations sell them is beyond dispute; that most of their sales are made on this basis is not so evident, particularly when the cost of delivery, usually paid by the customer, is considered.[38] That they sell at generally lower prices than competing stores is not proved to the satisfaction of all; but that they compete successfully by using a price appeal cannot be questioned. The larger houses seem to have a real advantage in

[36] The liberal attitude of the mail order house toward returns may be partly responsible for this, for when small dealers make special orders they expect the customer to take the goods.

[37] The largest sales for any department store in 1917 were under $50,000,000, whereas the sales of two mail order houses in that year were greater than this by over three times. See p. 224.

[38] Bulky articles need not be carried in stock. Consumers expect some time to elapse before receiving such articles by freight and so the mail order house utilizes the drop shipment method of the jobber and has the articles shipped directly from the factory at which they are made, or from its own district warehouses. Furniture and heavy hardware, in particular, can be handled in this way.

this regard if they wish to use it.[39] But it must be remembered that price is only one strong appeal of such houses: variety of goods guaranteed to give satisfaction, the ease of ordering from a catalogue and on the negative side, the inefficiency of small competing stores, all have a powerful influence favoring the great mail order house.

Systems.—Highly systematized methods of filing orders and filling them have been developed in the larger houses so that orders can be assembled, packed, and shipped with a minimum of cost and the maximum of speed. One large Chicago concern has its work so well in hand that all orders are through the house in twenty-four hours. The goods in a single order, which must come from various departments, are scheduled to reach the packing room at a certain definite time, with an allowance of but ten minutes. Orders may arrive one hour early, but they are sorted in ten minute periods.

Disadvantages.—Among the disadvantages under which mail order establishments work is the high cost of demand creation which results from the necessity of utilizing such an enormous amount of advertising. The few figures that are available seem to indicate that even excluding the cost to the customers for delivery the expense of doing business in mail order houses is as great as is that in competing stores if not greater.[40] For although there are economies in clerk hire and at other points, resulting from the wonderful systematization of the business and the efficient methods and appliances

[39] With regard to this low price appeal it must not be forgotten that a good deal of mail order business is carried on by relatively small firms, which do not have any of the advantages of large scale business and so probably labor under the disadvantages of mail order business without its compensating advantages of variety of goods and great purchasing power.

[40] Nystrom estimates that the average cost of doing business in large mail order houses is about 22 per cent of sale, ranging from 18 to 26 per cent. Investigations in ordinary retail store business have given figures ranging from 10 to 27 per cent for rural stores, the chief competitors. See Nystrom, *op. cit.*, pp. 65–67, 305–306; also Curtis Publishing Company, *Selling Forces*, pp. 178–179.

utilized, their cost of demand creation, e. g., the cost of printing and mailing catalogues, is very large. Unlike the local retail stores their clientele is not located in the neighborhood and so it is not naturally convenient to trade there, and neither does it comes under the personal influence of the proprietor or his subordinates. Hence such an establishment must be continually advertising to sustain and increase its business, and it must take great pains to keep the good will of customers.[41]

The mail order business is closely tied up with one class of ~~customer—the farmer.~~ When the farmer prospers the mail order ~~house prospers, but when~~ the farmer is unable to buy, the business of the mail order house suffers a great decline.

In times of rapidly changing prices, the fact that prices as published in the catalogue will prevail until another is published may involve the company in great loss of trade or money. When prices are rising, many orders will be filled at a higher cost than was anticipated when the goods were priced. This will be true unless they have been purchased at lower prices, or unless the order for the higher cost goods is not filled. When prices are falling rapidly the catalogue prices are often higher than are those in competing stores.

Transportation costs to customers are a disadvantage in this kind of business which cannot be overlooked. Even if they are not borne by the house they add to the customer's cost—although it is claimed that he often fails to consider this.[42] Deliveries, moreover, are necessarily slow, compared to the convenient and immediate delivery from the local store. The cost and time of shipment from Chicago to remote places have been responsible for the establishment of branch houses in various parts of the country.

[41] See *Printers' Ink,* July 19, 1917, p. 8.

[42] In cities and in towns mail order houses have begun to lower transportation costs by sending a number of orders in a single car once in two or three weeks. This carload consigned to a drayman is then distributed by him. In this way both railroad and dray costs are reduced, and deliveries are speeded up.

Goods are not seen by the buyer before they are purchased. No matter how generous a concern may be with its guarantees of satisfaction many customers do not like the necessity of returning goods, nor of waiting several days for them only to find that they are not what are wanted, or that a part of the order was not filled. The best houses through the excellent descriptions of their goods have gone far in eliminating this difficulty. But there are many things which it is difficult to describe accurately, and even with the best of descriptions and of intentions the purchaser may yet be led astray or left uncertain.

Finally, in addition to the great difficulty in getting the good will of customers and the lack of the personal service so many customers desire, the volume of mail order business has undoubtedly been curtailed by the appeal of local merchants to community pride. The sneer of the local merchant at the mail order customer and the slogan "buy at home" have kept many an order from finding its way to the distant mail order house. The mail order houses are meeting with new selling problems in recent years which have made many question their future. The introduction of the automobile enables farmers to go to near-by towns and cities with greater ease, and so at the same time it is sounding the doom of many country stores the automobile is also having an adverse effect on mail order business. The introduction of the chain store into smaller towns and cities seems also to be making great inroads upon mail order business. Because of their ability to sell at prices which are as low or lower than mail order prices they obtain much of the trade which formerly went to the mail order houses.

C. The Chain Store.—A chain store consists of a number of unit stores operating under a common management and control, and following common policies and utilizing common methods of operation which are determined by the central management. The chain store combines to a large degree the advantages of large and small scale retailing. On the

one hand it enjoys the economies of departmentization, large purchases, standardization of methods, and skilled executives. On the other hand, it reaches to the very door of the consumer, giving all the conveniences in location of the neighborhood store.

Although the chain store was in existence in this country before the Civil War its most rapid growth has been since that time, particularly since the eighties and even more especially since about 1910—a period of rapidly rising prices. The volume of business of some chains is far greater than that of the greatest department stores and is surpassed by but one great mail order house.[43] The number of stores in chains ranges from two to two thousand or more, and, if coöperative retail buying organizations are included, to several thousand.[44]

Means of Control and Ownership.—Chain store systems are controlled in several ways. (1) Some are controlled by firms formed for the express purpose of carrying on a chain of stores. (2) Others are controlled by retailers themselves—that is, by groups of retailers who form a chain primarily as a means of obtaining economies in buying.[45] (3) Jobbers sometimes own chains which they have acquired through the failure of customers, through the desire to keep control of fields in which retailers were buying directly of manufacturers, or

[43] The following figures for 1919 show the volume of business in a few of the chains:

Great Atlantic and Pacific Tea Co., Inc.	$194,646,959
Woolworth	119,496,107
American Stores	76,401,889
United Cigar Stores	61,874,053
Kresge	42,668,060
McCrory	11,487,045

[44] There are more than 8,000 stores in the United Drug Company—the "Rexall" stores.

[45] These, however, are not always considered chain stores. The term is more usually applied to stores controlled by a single owner, whereas retailer controlled chains are more in the nature of coöperative jobbing organizations, each retail unit controlling its own activities as does any independent store.

through the desire to enter new fields or new territories. (4) Manufacturers' chains are usually formed because of the inability of the producer to find satisfactory means of marketing through ordinary retail channels or because it is anticipated that larger profits will accrue. Because jobbers or retailers will not handle or push the manufacturers' products, or because of the failure of retailers to maintain prices, substitution, and other difficulties, many manufacturers have been forced into the retail field.[46] Finally, (5) there are chain systems composed of consumer coöperative stores. These stores, which are widespread in Europe, come into direct competition with the privately owned "multiple" or chain stores.

Chain store systems are found in almost all retail lines. More familiar are the great chains found in the grocery and restaurant business, the variety ("five and ten cent stores"), tobacco, and shoe business. But they are found in many other lines, such as drugs, hats, meats, dry goods, hardware, clothing, automobile accessories, confectionery, coal, and flowers.

Chain Store vs. Specialty Store.—The chain store, as in the case of the department store, finds its strongest competitor in the unit store. But with the recent rapid growth of chains in smaller towns and cities they have now come into direct competition with country general stores. Instead of competing with specialty stores of many kinds, however, as does the department store or mail order house, a chain system is usually confined in its activities to a single line; competing only with stores handling that line of goods, including of course, department stores. The competition with department stores is not important, however, because department stores specialize in the sale of shopping lines and most chain store systems sell convenience goods. This line of demarkation is not distinct, but the characterization is typical.

[46] It is generally claimed that the profits are less in the retail field than in the manufacturing end of the business; and so manufacturers are not particularly inclined toward this method of disposing of their product.

Peculiar Advantages.—Aside from the advantages which it possesses in common with other large scale organizations, such as large buying power, economies in accounting, advertising, delivery, and departmentization, the chain store has other advantages over competing specialty stores. (1) Goods which move slowly in one store or section of the territory may be found more readily salable in other territories and in other stores, and slow moving goods are quickly discovered. (2) In local competition the chain can lower prices to meet prices at one point without lowering them in other markets. (3) The expense of chain store operation is undoubtedly less than is that of the average unit store, although there is reason to believe that the most efficiently managed unit stores do business at as low a cost as the chain stores or even at a lower cost. A few new stores, poorly located stores, or a few ineffectively managed stores can greatly increase the average expense in a chain. Their lower operating expense is due to such things as the determination and use of superior methods, the use of low priced help closely supervised, and, often, the reduction of services. The cash-and-carry system, although not confined in its use to the chain store, is a common accompaniment thereof.[47] A few chains in the grocery field have introduced the self-serve store. This applies the cafeteria idea to retailing. It is assumed that a more economical service results, for clerks do not have to wait upon customers so extensively as they do in other stores. A chief advantage is that customers can pass near all the goods, and contemplate their purchases at leisure, without taking the time of the clerks or of waiting customers.

(4) A minimum of stock can be carried in a central ware-

[47] Apparently the savings in operating expense are not entirely responsible for the success of chain stores, for unit stores of the cash-and-carry type have not been conspicuously successful. Only when the advantages of superior buying are present do cash-and-carry stores seem to reach their maximum of success. The savings from the reduction of service alone are not always enough to offset the decreased service in the eyes of consumers.

house where storage expenses are far less per unit than on the shelves of the store in the retail district. Goods thus stored can be parceled out as the demands of the units require and the stock carried can be held at a minimum because of the better facilities for knowing the demand of the large number of stores, and the superior facilities for getting orders filled promptly in case of need.

(5) Standardized methods make it possible to utilize the one best way for doing each thing. The services of a few experts can be felt throughout the organization as a result of this specialization and standardization in the system—for example, uniformity in window displays and store arrangements, in hiring and training employees, in store service and selling policies. High administrative expense and the high salaries that must be paid to these experts tend to offset some of the advantages but when spread over a large enough number of units these expenses become less important.

(6) *Price Appeal: Turnover.*—With lower unit expenses than their competitors and lower costs of merchandise it is evident that the chain stores, if they desire, can make an effective price appeal. And they do so to a very great degree.[48] The policy of low prices and rapid sales is nowhere carried on so successfully as in the better chain store systems.[49]. Unfortunately, turnover figures of chain stores cannot be closely compared with those of unit stores. The exceptional store of a chain should not be taken as a sample, for its record will be offset by the showing of the poorer stores. Furthermore neither a single store's stock-turn nor the average of all the

[48] C. W. Hurd and M. Zimmerman, "How Big Retailers' Chains Outsell Independent Competitors," *Printers' Ink*, Dec. 3, 1914, pp. 69–70.

[49] Whereas the turnover of city grocery stores is around ten or twelve times per annum, chain grocers have been reported as doing as well as forty times; cigar and tobacco stores average around four to six, one great chain is credited with as high as fifty, for some of its stores; private variety stores have a turnover of about eight to ten, five-and-ten-cent chains of from ten to twelve. *Idem, Printers' Ink,* Dec. 3, 1914, p. 66 ff.

stores is a proper unit to compare with the competing unit store. For the stores of the chain might have a very high turnover but there might be a very slow turn of the reserve stock, although this is not likely when the chain is well organized. The only true comparison would be between the turnover of the whole chain organization, retail and wholesale, and that of the jobber and his retailer. This it is impossible to make in any satisfactory way.[50] In so far as a rapid turnover can be accepted as a criterion of success in retailing, it is evident that the chain stores are on the right track. Their rapid turns show they are utilizing their superior merchandising efficiency to strengthen their organization at the point where the average store is weak.

(7) *Superior Buying.*—Not only do chain stores have a lower expense of doing business and a more rapid turnover than competing small stores, but they also have the superior buying ability of large establishments.[51] In the chain store at its best, this means lower costs,[52] better goods, a greater variety, and more consideration from those whose goods they purchase.

[50] Converse makes an interesting comparison, however, which supports the assumption of the rapid turnover of chain stores. He cites data to show that the average turnover period of wholesale grocers is 70 days and of retail grocers is 46 days, a total of 116 days, and that "A chain store operating its own wholesale warehouse and turning its stock 7 times a year requires only 52 days to effect a complete turnover."—Paul D. Converse, *Marketing Methods and Policies* (1921), pp. 319–320.

[51] "The success of our organization may be attributed to great buying power and ability to take advantage of all cash discounts, combined with economy in distribution."—This is a statement by F. W. Woolworth in a letter of Feb. 14, 1912, in connection with the reincorporation of the Woolworth Company, as quoted in A. S. Dewing, *The Financial Policy of Corporations* (1920), Vol. IV, p. 57.

[52] Manufacturers sometimes agree to extend the time for cash discounts by two or three weeks. In this way large buyers can finance many of their purchases out of the sale of the actual goods. This is particularly true of the chains with rapid stock-turns. This scheme is in the nature of an inside price and is not looked upon with favor by small stores, or by the manufacturers themselves.

(8) The larger chain stores have gone as far as the mail order house and the department store in departmentization and specialization of administrative departments. Separate accounting departments, buying departments, store fixtures, real estate departments, or even subsidiary companies for purchasing the real estate utilized, are important parts of the business of larger systems; and the standardization of methods assures that the one best way will be used in each store.

Personnel Problem.—As with other large scale organizations the chief disadvantage of the chain store is the personnel problem. In the case of chain stores operating throughout large sections of the country it is evident that this problem is even more important than it is to the department store, or mail order house, in which the owners can be in close proximity to their business all the time. How to get hired managers to run stores effectively is as yet an unsolved problem. Much is being done through partnership plans, careful training, improved wage systems, contests, inspection, and other methods. But the fact remains that the hired manager is not likely to be so efficient as the same man would be in his own store, either in watching the little things that make for success or in gaining the good will of customers. Furthermore, when a good manager develops he is likely to go into business for himself. In the case of those chains which are made up of retailers who coöperate in owning a central buying organization this particular problem, however, is not found.[53]

Consolidation.—A tendency toward consolidation is evident among chain store systems and the last few years have brought many combinations of competing systems. As the advantages which such stores have over ordinary stores are offset to some extent by the growth of competing chains, it appears that new advantages are sought through greater size; and undoubtedly the mere accumulation of profits or financial

[53] A good illustration is the United Drug Company, the "Rexall" stores. See Paul T. Cherington, *Elements of Marketing*, pp. 173–186, for a discussion of this point.

power leads to the same end when the more direct method of establishing new stores does not seem so feasible.

Other important tendencies involve the control of factories and the expansion of the business into smaller towns and cities. Many small towns now have units of large chain store systems. In the West the "Penny" system of dry goods stores limits its activities entirely to smaller towns and cities. Where towns are too small to warrant the establishment of stores some manufacturers' chains have resorted to the establishment of exclusive agencies,[54] which, although not direct parts of the chain, share in many of its advantages.

Future of the Chain Store.—So long as jobbers and manufacturers continue to desire new and wider markets for their products than existing retail methods provide, so long as large purchases and purchases for cash can be made at lower prices, and so long as inside prices are given to powerful buyers, we can expect to see chain stores increase in number and importance. Consolidation will also continue, for as the special advantages which chain stores now exert over their small competitors are minimized through the establishment of competing chain stores, competition will lead to consolidation to gain the possibilities of increased power through the use of larger and larger units. With the further advantages of low costs, rapid turnover, and convenience in location near the consumer it seems that the chain store is likely to find for itself an increasing field of usefulness.

[54] An exclusive agent is a retailer to whom has been given the exclusive right to handle a certain product or certain products in a particular territory.

CHAPTER XIII

DISTRIBUTIVE COÖPERATION

Distributive coöperation is the control of marketing agencies by associations of producers, consumers, or middlemen. It involves the substitution of an associated control of steps in distribution for that which is normally exercised by independent agencies. This control is exercised by the parties who formerly sold to or bought from these independent agencies. Thus, it means for producers the associated control of the channels through which their products reach the market. It brings about for consumers associated control over the channels through which they are supplied with the commodities they buy. It involves for merchants associated control over the channels through which they purchase merchandise for resale.[1]

[1] A mass of literature has appeared upon the subject of coöperation. But unfortunately there has been little unprejudiced investigation of the results of coöperation. Of the more accessible sources of information the following incomplete list will be of value.

The books which are mentioned are useful both in themselves and for the bibliographies and footnote references which they contain: J. L. Coulter, *Coöperation among Farmers* (1918); W. W. Cumberland, *Coöperative Marketing* (1917); E. P. Harris, *Coöperation: the Hope of the Consumer* (1918); B. H. Hibbard, *Marketing Agricultural Products* (1921), Part III; G. H. Powell, *Coöperation in Agriculture* (1913); Albert Sonnichsen, *Consumer's Coöperation* (1919). The U. S. Dept. of Agriculture, Bul. No. 547 and the U. S. Supt. of Documents, Price List 68 (5th ed.), also contain bibliographies.

The U. S. Department of Agriculture and several of the State Agricultural Experiment Stations have published many documents relating to coöperation. Among the more important of these are: The U. S. Department of Agriculture, Bulletins 394, 541, 547, 860, 937; Farmers' Bulletins 718, 1144; Yearbook of Department of Agriculture, 1919,

In a more restricted sense coöperation is confined in meaning to the association of agricultural producers for the sale of their products and the coöperation of final consumers in purchasing the goods which they use. As these are now the more important aspects of coöperation the present discussion is confined to them.[2]

Coöperative Organization vs. Independent Organization.—Important differences exist between coöperative distribution and the ordinary methods of marketing. These differences, however, are more a matter of control than a difference in the actual methods used. The ultimate purpose is to gain some advantage for the persons associated. This is usually found to relate, directly or indirectly, to some price advantage. It may be lower prices to the consumer, higher prices to the producer, or lower prices for goods purchased for resale by the merchant. These price advantages the coöperators hope to obtain through their control of marketing; and they may result either from higher or lower prices, from the absorption of profits commonly going to middlemen, from the improvement of merchandising methods, or from the lowering of expenses.

Features of Coöperation.—Since the aim of coöperation is to control marketing in the interests of the producers or consumers who are associated, a type of organization has been developed to assure such control. The chief features of or-

Separate No. 819; Cornell University Agricultural Experiment Station, Memoir 28; The University of Minnesota, Agricultural Experiment Station, Bulletins 146, 152, 156, 164, 166, 167, 171, 184; The University of Wisconsin, Agricultural Experiment Station, Bulletins 238, 282, 314, 322; University of Kansas, Agricultural Experiment Station, Bul. 224; University of Iowa, Agricultural Experiment Station, Bul. 200.

Publications of the U. S. Grain Growers, Inc. (58 East Madison Street, Chicago), are descriptive of an interesting experiment in coöperation.

[2] There are a number of examples of central purchasing agencies owned and controlled by retailers. See a list in the *Mercantile Coöperator,* March 6, 1920. Their activities are discussed briefly in P. T. Cherington, *Elements of Marketing,* pp. 173–179.

ganization which differentiate the typical coöperative association from the usual business organization are these:

1. One vote is usually allowed per member, regardless of the amount of his investment.
2. No profits above interest at about the market rate are paid to shareholders on the money they invest.[3]
3. The division of dividends is based upon the patronage of the members and frequently of non-members—the "patronage dividend."
4. The "coöperative spirit" of loyalty to the organization is fostered.

The first three of these features clearly differentiate the coöperative enterprise from the ordinary form of business organization. Whereas the business enterprise which is engaged in marketing buys and sells goods or services for the purpose of making profits for those who own it, ~~the coöperative enterprise~~ functions primarily in the interest of producers or consumers—the patrons. It is controlled by them and is run for their benefit. The chief benefits to farmers arise from higher prices received for the crops which they sell through their organizations; the chief benefits to consumers arise from lower prices for the goods they purchase. In either case, if profits are made by the organization they go to the patrons of the organization—at least to those who are members of the organization—and not to independent "middlemen."

One vote per member and the market rate of interest on each member's investment assures the members that the organization will not be operated in the interest of a few large stockholders, who may be more interested in obtaining profit on their investment in the enterprise than in obtaining the highest, or lowest, prices for the benefit of the remainder of the producer or consumer membership. To make doubly sure that this is true most associations limit the number of shares one

[3] Many associations are now organized on a non-stock basis, as provided for in the coöperative laws of some of the states.

person may hold, and some producers' organizations allow only farmers to own shares.

The patronage dividend is a device for tying the interest of the members to the organization.[4] Any surplus above expenses and reserves, which in a business enterprise would be divided among the shareholders on the basis of the number of shares each owns, is by means of this device divided among the patrons of the association on the basis of their patronage of the organization. In the case of the producers' selling enterprise these dividends are commonly divided among the members on the basis of the volume of goods each has sold through the organization. In consumers' buying associations they are divided on the basis of purchases made.[5] The patronage dividend is particularly important only to those organizations that find it desirable, and possible, to make profits above expenses. But such a surplus is only incidental. The society is operated not to make profits from the enterprise as such, but to obtain higher, or lower, prices for the members in their sales or purchases.

The fourth point mentioned, the "coöperative spirit," is a less tangible element. It is neither economic nor legal in its essence. It is considered so important, nevertheless, by some of the advocates of coöperation that no discussion of the movement should fail to mention it. This coöperative spirit is an intangible something, which when developed binds the

[4] When coöperative associations organize under the ordinary corporation laws it frequently develops that these coöperative features cannot be legally enforced. Consequently, such organizations have often developed into purely "profit-seeking" private enterprises. To make it possible to carry out these features of coöperation many states have passed laws making provision for these features. Something over three-quarters of our states now have these laws.

[5] With producers' associations the number of units handled is likely to be the basis of division, since those who sell when the market is dull are not thereby penalized. This is not usually practical in buying organizations and so the money value of purchases is used. Sometimes non-members are encouraged to patronize the association by giving them some of the benefits of the patronage dividend.

members together in loyalty to their association. It is probably safe to say that the fundamental reason for emphasizing this feature of coöperation is the tendency for the coöperators to undervalue the possible future benefits of coöperation once the glamour of a new enterprise wears off. They may, consequently, sacrifice those benefits in order to realize immediate benefit from an act of "disloyalty" to their association. Competing business organizations commonly endeavor, for example, to attract the members of the association by means of some price advantage. If the members take advantage of this, their association is thereby weakened and may even fail. Then, it may be, the independent organization will no longer confer the benefit which drew the members away from their organization.[6]

I. Agricultural Coöperation

Coöperative selling by associations of farmers has been more largely developed in the United States than has coöperation by consumers. During the past fifty years the development of coöperative associations has progressed until today a large part of the production of our important grain, dairy, and fruit growing sections is marketed through local coöperative associations and an appreciable part of the local associations are members of coöperative enterprises engaged in wholesaling the products of their members. The chief of the Bureau of Markets of the United States Department of Agriculture states in his 1920 report, "There are in this country to-day approximately 15,000 farmers' organizations, with a membership of approximately 2,000,000 persons."[7] At the present time over half

[6] In agricultural coöperation this difficulty is now being attacked by means of contracts between the grower and his association. See O. B. Jesness, *Coöperative Marketing,* Farmers' Bulletin No. 1144 (U. S. Department of Agriculture, 1920), pp. 12-14.

[7] *Annual Report of the Chief of the Bureau of Markets,* U. S. Department of Agriculture, Oct. 9, 1920, p. 6.

the grain arriving in Chicago comes from farmers' elevators,[8] and over three-fourths of the live stock going into the South St. Paul market is shipped by coöperative associations.[9]

Organization Features.—A large number of associations in this country do not strictly adhere to the features of coöperative organization just described. This is due in some instances to a failure to know or recognize their importance. In other instances the coöperatives have been organized, in the absence of coöperative laws, under the ordinary corporation laws.[10] Under such conditions the features of a coöperative business organization can be enforced only by mutual agreement, and this is often lacking after the first enthusiasm wears off. With the passage of coöperative laws in over three-quarters of our states this difficulty, however, is being overcome. Under such laws the important features of coöperative organization can be enforced.

The relations of coöperative associations with the growers vary: the coöperative grain elevator usually buys for cash, in order to compete successfully with the independent elevators which purchase in this way; many other associations, particularly those dealing in highly perishable crops and live stock, pool [11] their sales and distribute the proceeds only after payment for each shipment has been received from the central

[8] James E. Boyle, *Speculation and the Chicago Board of Trade* (1920), p. 51.

[9] Letter from W. A. McKerron, General Manager of the Central Coöperative Commission Firm, St. Paul, May 21, 1921.

[10] It is of interest that Section 6 of the Clayton Anti-Trust Act exempts certain types of associations of farmers from the operation of the "anti-trust" features of the act—those which are non-stock, non-profit organizations organized for mutual benefit.

[11] See p. 255. "By pooling is meant averaging the returns received for products sold during a certain period, or for certain shipments, so that each grower having products of the same grade receives the same price. This method of operation protects the individual member from loss because of unfavorable market conditions of a temporary nature."—O. B. Jesness, *op. cit.*, p. 14.

market, or they may pool the proceeds for certain definite periods, as for a month, or two weeks, or for a whole season. Some associations require their members to sign contracts binding them to give their business to the coöperative.[12]

Largely Confined to Local Markets.—The efforts of the farmers' associations are frequently confined to the local market.[13] The distributive functions they exercise and the manner of their performance are primarily the same as those of other local agencies which ship the growers' product to the central market. The manner of control, however, is different. Whereas other local shipping agencies are independent of the growers, controlled by local middlemen or by wholesale dealers of the central market, these are owned and controlled by the growers themselves. The organizations are of varying complexity and their permanence likewise varies.[14] They may be organized simply for a season or even for a single shipment, or they may be incorporated, own property, and carry on extensive purchasing activities in addition to

[12] This is a part of the plan of the new U. S. Grain Growers, Inc. See pp. 254–255.

[13] See, however, pp. 248–255.

[14] The most highly developed organizations are those of the western states, the California Fruit Growers' Exchange, the California Associated Raisin Co., and others handling prunes, apricots, nuts, etc.

"No very positive answer can be given to the question why this marketing machinery has been developed in some of the growing districts and not in others. It is probable, however, that one very important consideration is the need. The farmer who lives a hundred miles or so from a great city can have some knowledge of the conditions there and of the dealers with whom he will come in contact. For the small grower who lives a thousand miles or more away it is much more difficult. Moreover, where the distance is great the freight rate is of more importance, and the desirability of shipping in carload lots is greater. For these and similar reasons the distant growers have a stronger motive for organizing marketing associations of their own, and if an independent organization enters the field it is likely to find it easier to establish relations with the grower."—*Report of the Federal Trade Commission on the Wholesale Marketing of Food* (1920), p. 50.

their sales efforts.[15] Local associations are sometimes associated in regional or state organizations and there have been some attempts at national organization. But the regular central market agencies are usually utilized in their selling operations, although some, as the California Fruit Growers' Exchange, have their own bonded representatives, or salaried selling organizations in the larger markets. Growers of other products have more recently entered the field of terminal market selling.[16] The Farmers' Educational and Coöperative Union has developed coöperative live stock commission houses (The Central Live Stock Commission Company) in Omaha, Kansas City, Sioux City, St. Joseph, and Denver. The most recent attempts have been made by the American Farm Bureau Federation, in coöperation with other large agricultural organizations, to control the marketing of the country's grain crop through the newly organized Grain Growers Incorporated,[17] and to market live stock through the National Live Stock Producers' Association. Even in these instances the existing machinery of the central market is largely utilized.

Purpose of Local Associations.—These organizations perform the same functions in the growers' market as do independent dealers handling the same products. There is no reason to believe that they are on the whole any more efficient in operation than are the local dealers, except that a single farmers' association, when operating on a larger scale than do the independents, may achieve substantial economies.[18]

[15] Sometimes such associations buy many things for their patrons, particularly such bulky products as coal, flour, and machinery. From this to the actual formation of a coöperative store has sometimes been a natural step.

[16] See pp. 250–255.

[17] See pp. 254–255.

[18] Coöperatives do operate on a larger scale in the grain trade at least. In 1916–17 the average commercial line elevator purchased 77,250 bushels of grain, the average coöperative line 136,825 bushels; of individual elevators the coöperatives averaged 152,792 bushels and the independents 102,934 bushels. *Report of the Federal Trade Commission on the Marketing of Grain,* Vol. I., p. 117.

But these associations are frequently organized to meet real evils, such as the failure of the local shipper to pay enough for better grades, his retention of too large a margin, monopoly or combination among shippers; and at some points they have been organized because no specialized local dealer existed. Even the threat of association, or the presence of growers' organizations in another field whose members contemplate associative marketing, has sometimes brought better service from local middlemen who had not been giving the growers all the market warranted.

The chief object of these organizations is not to gain profit on the selling operation, but to get a higher price for the farmer's crop. The patronage dividend, consequently, sometimes plays a large part. In the selling of grain, for example, the practice of the trade often necessitates the outright purchase of the farmers' grain by the coöperative elevator.[19] In such cases, sound business practice requires that the goods be handled on a sufficient margin to cover the risks of the business. But outright purchase at the local shipping point is not generally prevalent in the sale of fruits and vegetables, and of live stock consigned to central market dealers. In the sale of these, and of most farm products, the growers must wait for the proceeds of the transaction.[20] Under these conditions the association may act as a sales agent for the growers; the risk is less,[21] and the costs are divided according

[19] *Op. cit.*, pp. 94–95.

[20] Grain elevators may obtain some protection against loss by "hedging," pp. 362–368, but this is not available to fruit and live stock associations.

[21] A considerable saving over the usual costs of shipment through independent buyers has been made in shipping live stock under these conditions. See E. Dana Durand, *Coöperative Livestock Shipping Associations in Minnesota,* The University of Minnesota, Agricultural Experiment Station, Bul. 156 (1916), p. 7; and B. H. Hibbard, L. G. Foster, and D. G. Davis, *Wisconsin Livestock Shipping Associations,* University of Wisconsin, Agricultural Experiment Station, Bul. 314 (Aug., 1920), p. 6.

to the amount of business done. The proceeds above costs may be paid to each patron for his own product, which is separately sold at the central market; but in some cases it has been found more satisfactory to pool both profits and costs on the basis of the units handled during a given period. In this way all members bear equally any fall in price and gain equally in case of a rise.[22]

Improved Grading and Improved Products.—It is particularly true of the more perishable commodities that there are wide variations in prices for graded as against ungraded products. And one great gain from the coöperative movement has been the improvement and standardization of products to conform more nearly to the demands of the market. This results in higher prices for the farmer's crops, and in turn has led to better farming, for it has made the farmer appreciate the need for better products.[23] This is very important. For the local buyer often pays a flat price, or grades products roughly, thereby overpaying producers of low quality goods and underpaying the producers of superior crops. Paying a uniform price penalizes the best producers, and grading too low penalizes all producers. The formation of farmers' associations has had an important effect on such practices, since they secure for the individual farmer the market price for the particular grades he has produced.[24]

[22] To do this successfully necessitates a system of careful grading that will make it possible for each grower to be paid according to the market value of his goods.

[23] "The farmer is frequently criticized for lack of attention to the uniformity and quality of his products. As an individual he is powerless to remedy this weakness. A multitude of other duties requires his attention; he does not have an opportunity to become intimately acquainted with the demands of the trade; and his production is too limited to attract much attention, even though he uses a great deal of care in the handling and preparation for market of his products."—O. B. Jesness, *Coöperative Marketing,* U. S. Department of Agriculture, Farmer's Bulletin No. 1144 (1920), p. 4.

[24] Managers of farmer associations make the assertion at least that this is true and some investigations made by the writer in 1913 lead

Furthermore, these associations make it more likely that growers will get the top price for their products. It is said, apparently with justice, that the privately owned shipping agencies, in business to profit for themselves from the services they render, sometimes pay a lower price than the market warrants. In this way the margin from which they must obtain their profit is increased. It has been asserted that as coöperation has grown and shown its strength, the ends which are desired can often be gained merely from the knowledge of the independent shipper that he is constantly competing with a potential competitor in the association which the farmers may organize. Again, the size of an association's shipments commands respect at the central market and their competition at the local market has forced many independent dealers to mend their ways. In the case of such products as fruits and vegetables, for which there are no generally accepted grades, these associations have promoted better agriculture, established brands of their own, and through making them known to their customers have secured the full benefit of their superior production.

Federation of Growers' Associations.—There has been an important growth in recent years of coöperative wholesale organizations. It is said that the farmer does not receive the full benefit of his organization unless local associations federate in order to exercise more influence in the central market. Among the benefits to be derived from marketing federations the following are commonly stressed:

1. Products can be stored from the season of abundance and sold when the market conditions prove to be satisfactory,

him to believe that much has been accomplished. There is much pressure brought to bear, nevertheless, which keeps the best results from being achieved. If farmer A's corn is grade No. 1 and the corn of farmer B whose farm lies next to farmer A is graded 2 or 3 a dispute is very likely to result which may in the end lead the manager to meet the situation as the independents sometimes say they have been forced to do, namely, to grade it all alike.

and in the most satisfactory market. This is particularly important with those commodities whose markets tend to be glutted in the harvest season. By helping the farmer to hold his products, through the provision of storage facilities and assistance in financing, by studying the market to determine the best time to sell, and by controlling an appreciable part of the supply, such federations, it is urged, can steady the market and procure more satisfactory prices for the grower.[25]

2. A federation, because of the volume of its business, can afford to keep in close touch with the market. Some associations, for example, go so far as to have private wires to their principal markets. Few local associations can afford any telegraphic expenses, but when a number coöperate the expense to each is small.
3. The association can bring pressure to bear in educating growers in the production of the best market types and in the proper preparation of the product for market.
4. Products can be graded and similar commodities from various points packed and sold together in large quantities.
5. The federation may advertise its products, establish brands and trade-marks, and otherwise assist in the creation of demand.
6. Many miscellaneous services can be performed: freight claims can be adjusted; pressure can be brought to bear to correct abuses in central markets; legislation can be influenced.

Extent of Wholesale Activities.—But by no means the whole field of wholesaling is taken over by these central associations. The actual sale of the goods is generally made through independent middlemen of the central markets. Indeed, until recently little central market work has been carried on by the coöperative organizations engaged in the sale of the

[25] See Theodore Macklin, *Marketing by Federations*, University of Wisconsin, Agricultural Experiment Station, Bul. 322 (Dec., 1920).

staple products. This is probably due to the fact that such products are already merchandised efficiently and cheaply in the central markets so that a wholesale coöperative organization could help little if any. It may also be possible that the opposition of the organized interests [26] at the central markets has militated against such organizations as have been attempted. There has been, however, a growing demand for central market wholesaling by coöperatives. In almost every fruit and vegetable growing region in the country such associations have been attempted, some of which do several millions of dollars of business a year. In the creamery business some centralizing of market information and control has been attempted in a few instances, but it has not developed far, although Minnesota creameries are now federating and the Wisconsin cheese producers have a large central organization.[27] Potato shippers in Michigan, Minnesota, Virginia, and other states now have central federations of potato shippers. There are also federations of cotton growers, and the burley tobacco growers have recently organized an association with about 50,000 members. In Canada, a central warehouse and selling organization for wheat has been established at Winnipeg, and farmers' terminal commission companies handle live stock in several markets. In addition to these the United States Grain Growers Incorporated and the National Live Stock Producers' Association have recently been organized.[28]

[26] "One of the most important and difficult problems which we have to solve is how to assist coöperative agencies to educate the business men of the country so that they will concede the right of the farmer to enter the marketing field. Many successful business men are engaged in a number of enterprises, few confining themselves to one field of endeavor, and there appears to be no valid reason why the farmer should be denied the same privilege which they enjoy."—U. S. Department of Agriculture, *Report of the Chief of the Bureau of Markets* (1920), p. 6.

[27] See Theodore Macklin, *op. cit.*

[28] See pp. 254–255.

Most of these associations are confined in their sales activities to single products or closely related goods. A number are found in the fruit, grain, dairy, and live stock industry. But some cover a wider range of products. The Michigan Potato Growers' Exchange sold 2,200 cars of potatoes in 1920, and in addition to these it sold several hundred carloads of celery, onions, cabbage, squash, and other vegetables, and hundreds of cars of fruit, such as pears, apples, and plums.[29] In addition to these it marketed grain, beans, hay, and straw. The Exchange also has a purchasing department which does a large business. As a rule federations do not operate on a merchant basis. This would involve the necessity of raising large sums of money as well as the establishment of effective credit relations with banks. More often they operate on what is practically a commission basis, with the difference that any profits belong to the farmers themselves.

The California Fruit Growers' Exchange.—The best example of federation is found in the California citrus fruit industry. The basis of the largest organization is some 10,500 growers of citrus fruits in the state who are organized in over 200 local associations of from 40 to 200 members each. Each local association commonly picks and "assembles the fruit in the packing house, and there grades, packs, and prepares it for shipment," [30] and each has brands under which it sells its

[29] Whereas the average grower or local association would have shipped to Chicago or Detroit, the nearest large markets, it sold less than 25 carloads in these markets, shipping rather to smaller and less known markets. The reason assigned is that in seasons of heavy production, these cities are dumping grounds for fruits and vegetables.

[30] This brief description is adapted mainly from a report by Mr. G. Harold Powell, General Manager of the California Fruit Growers' Exchange, included in George K. Holmes, *Systems of Marketing Farm Products*, Report No. 98 of the U. S. Department of Agriculture, pp. 169–171. I am indebted to Mr. Paul S. Armstrong, advertising manager of the Exchange, for the statistical data and for more recent information on the organization features. A more extended discussion may be found in W. W. Cumberland, *Coöperative Marketing as Exemplified in the California Fruit Growers' Exchange* (1917), (Princeton University

product. Each association uses, also, the brand of the central exchange—"Sunkist"—which appears on the wrappers and by which the fruit is known to consumers. The local brand appears only on the box. There are twenty district exchanges, each of which is the medium of communication with the central exchange in the sale of the products of the local associations which belong to it. They also procure cars, receive and divide the returns among the local associations, and generally represent them with the central exchange in the handling of the larger problems of the industry.

The Central Exchange.—The California Fruit Growers' Exchange was formed, and is controlled, by the district exchanges. Its main function is to furnish marketing facilities at cost. In doing this it places bonded agents in the main markets of the United States and Canada, gathers information of the market, is informed by telegraph of the sale of each car of fruit, and furnishes information to the local exchanges and associations through the medium of a daily bulletin. It "takes care of litigation that arises in connection with the marketing of the fruit; handles all claims; conducts an extensive advertising campaign to increase the demand for citrus fruit"; and develops new markets. "The exchange maintains district managers in all important cities of the United States and Canada. These employees are exclusively salaried agents engaged only in the sale of fruit, in the development of markets, and in handling the local business problems of the Exchange."

It appears that even this large organization does only what a large independent concern would do in its marketing activities, what in fact some large concerns are doing, although their activities are not usually so intimately connected with the growers' own farm problems as are those of the local ex-

Press); or in J. W. Lloyd, "Coöperative and Other Organized Methods of Marketing California Horticultural Products," *University of Illinois Studies in the Social Sciences* (1919).

changes.[31] But this exchange was formed to meet a peculiar problem—the lack of a market large enough to take the growers' products at a profitable price—a problem which had

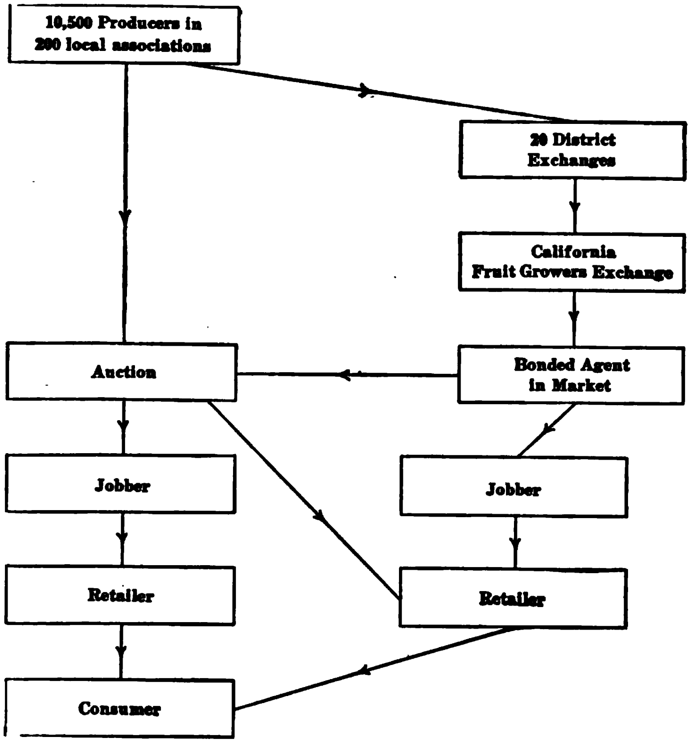


DIAGRAM V.—Coöperative Fruit Marketing by California Fruit Growers

not been solved for the growers by existing marketing agencies, but which they have apparently solved successfully through their coöperative enterprise.[32] Its chief tasks, in contrast

[31] Apples in New England and in other sections, however, are often picked by independent buyers.

[32] In 1907 the Association began advertising to widen the orange market. "In the twelve years since the first Sunkist campaign was launched in Iowa, the consumption of California oranges has doubled. The

with those of most growers' marketing organizations, have been to create a larger demand for the growers' produce, and to maintain proper methods of physical distribution for their highly perishable products grown far from the important markets.[33]

United States Grain Growers Incorporated.—Perhaps the most ambitious project ever aimed at the control of wholesale marketing by the growers themselves is the United States Grain Growers Incorporated, organized in the spring of 1921. This association arose out of the activities of the so-called "Committee of Seventeen" appointed by President Howard of the American Farm Bureau Federation.[34] The plan adopted by this committee after six months' investigation, beginning in August, 1920, led to the adoption of a plan for marketing the grain crop of the country. The proposed program has been outlined by the Committee, as follows:

"Grain selling will be concentrated in the hands of a national sales association, with membership and voting control limited to actual grain growers. This sales association will establish branch offices at all principal grain markets, including seats on boards of trade if they are found to be desirable. It will establish a complete system of gathering and interpreting statistics of world conditions affecting supply and demand. It will provide adequate means for financing orderly grain marketing through a subsidiary finance corporation. A subsidiary warehouse corporation will provide terminal and district warehouses with cleaning and condi-

American consumer has been taught by coöperative advertising to eat nearly twice as many oranges as before."—Don Francisco, *Coöperative Advertising*, p. 8. (This is a pamphlet published by the Exchange.)

[33] For a further discussion of these points see Carl C. Plehn, "The State Market Commission of California," *American Economic Review*, Vol. VIII (March, 1918), pp. 1–27.

[34] The farm bureaus of the various states have been exercising a wide influence on agriculture. Among other things they have been prominent in organizing local coöperative associations. See *American Farm Bureau Organization, What Is It?*, published by the Federation, 58 So. Wabash Avenue, Chicago; also O. M. Kile, *The Farm Bureau Movement* (1921).

tioning machinery. An export corporation . . . will find foreign outlets for surplus grain. . . .

"The best features of all successful coöperative marketing companies have been included in the new marketing plan. . . . The plan makes no attempt to put grain marketing at once on a nation-wide pooling basis, but provides means for the development and extension of pooling as experience proves its adaptability to the grain business."[35]

Under the Committee's plan, existing coöperative elevators and such new associations as may be formed can become an integral part of the new organization. In this way it is hoped that the thousands of these elevators now in existence will prove to be a nucleus about which the new organization can build. This will help to start operations on a large scale at once. Almost no changes, other than the method of control of the wholesale machinery, are proposed in the existing market machinery. Furthermore, it is held to be unnecessary "to secure contracts covering a large percentage of the grain of the United States before the sales association can begin to operate."[36]

The national organization is governed by a board of twenty-one directors, elected by representatives, who are in turn elected from various districts. The board appoints the business managers of the organization. The present plan involves a contract between the central agency and the local association whereby the latter agrees to deliver for a period of five years all grain received from farmers who belong to the national organization. There is also a plan whereby the grain of several associations may be sold at the discretion of the central body and the proceeds pooled on the basis of the quantity of grain each association ships.[37]

[35] *Outlined Explanation of the Proposed Grain Marketing Plan of the Farmers' Grain Marketing Committee of Seventeen*, published by the Committee, 58 E. Washington Street, Chicago, March, 1921, p. 1.

[36] *Ibid.*, p. 5.

[37] The plan of the new National Live Stock Producers' Association is described in the *Live Stock Marketing Plan of the Farmers' Live Stock Marketing Committee of Fifteen*, 608 So. Dearborn Street, Chicago.

Costs.—So far as the expenses of operation are concerned it is likely that little is saved through coöperation. A manager capable of running the organization with success is likely to require a salary as great as that received by the independent owner in profit.[38] It is likely, furthermore, that the lack of the profit incentive may weaken his efforts. The investment will be as great, and so the interest on the money invested must be as much, as the private dealer would expect on his own investment. There is little reason to believe that other costs—help, depreciation, running expenses—will be generally lower for the farmer association. There are instances, however, in which these may be lower. For example, there are often too many local grain elevators. No one of them is operating at a sufficient capacity to reduce costs to the low point a larger business can reach. By substituting one large business it seems that the farmer association may sometimes achieve real economies.

Furthermore, associations have often been formed at points where no efficient market organization of any kind existed. Each farmer marketed his own product through sale or consignment to the consumer, retailer, or central market dealer. At such points coöperation may accomplish results similar to those that follow the establishment of an independent middleman: i.e., transportation costs may be lowered by the combination of shipments into carload lots; individual farmers are relieved of the bother of attending to all the details of marketing their own products; and the knowledge and bargaining of a market specialist are substituted for the limited knowledge of the average farmer.

Combating Specific Evils.—More frequently, however, farmers' selling associations have been formed to compete with or to "eliminate" local dealers where it was felt that the farmers had a grievance against the independent middleman. Very often a single dealer monopolized the shipping, or a group of

[38] Many independent elevators, however, are also managed by hired employees.

dealers were thought to have an understanding whereby they kept prices down. That is, the margin taken out by the middleman was felt to be larger than was necessary to cover the costs of marketing and to allow him a reasonable profit. Local merchants have also been charged with keeping the price down by paying a uniform price for all grades, and of uniformly grading the product too low or deducting too much for tare.[39] It is in such cases as these that there is often real truth in declaring that the "profits" of the middleman are saved.

Finally, the individual farmer is often at a disadvantage in bargaining. This has been true, for example, in the sale of milk to city milk dealers. The organization of milk producers' associations has greatly strengthened the farmers' bargaining position.[40]

Social Results.—The social benefits which result from the organization of an association may be fully as important as the direct results. Individualism is modified in the interest of community endeavor, a community spirit develops, and the association of farmers in a business venture reacts beneficially upon their individual business methods.

"Orderly Marketing" and "Stabilization" of Price.—When coöperative associations federate to perform wholesale functions the results are likely to be much as have been described. But one important feature of the recent discussions of coöperative wholesaling deserves notice. That is the effort to "stabilize" prices through "orderly marketing." This may be done, in the first place, by influencing production so that it will accord more nearly to the demands of the market, as forecasted by the central organization. In the second place, this may be done by controlling the marketing of the crop so that commodities will go to the best markets at the most favorable times. Gluts and shortages will tend thereby to be

[39] See the *Report of the Federal Trade Commission on the Grain Trade*, Vol. I (1920), pp. 100, 198 ff.

[40] See H. E. Erdman, *The Marketing of Whole Milk* (1921), Chap. V.

eliminated, whether they be seasonal or temporary. The price will be "stabilized."

If a large proportion of any crop were controlled in this way it seems reasonable to believe that these results would follow. If the power were properly exercised the results might prove favorable to both producers and consumers. Uniform supply and stabilized prices are generally believed to be desirable. It is this which some of the associations of fruit growers and of walnut and cranberry growers have already accomplished, and it is this which the Grain Growers Incorporated hopes to accomplish.[41]

Failures.—There have been many failures in the coöperative movement. Associations have been formed where no need existed. Grain elevators have been built where the existing dealers were giving excellent service at a reasonable profit. Associations have been organized, sometimes with unfortunate results, by professional promoters whose interests were not always those of the farmers. Again, the competing dealers, particularly the great "line" elevators of the grain business, have used strenuous means to ruin the coöperatives, many times with success. In the failure of many associations the lack of loyalty on the part of members has played a large part. If a competing dealer offers a slightly higher price many farmers immediately desert their own organization. They will do so even though they may be assured that if the coöperative plan fails they will thereafter receive a smaller payment for their

[41] The legal status of such efforts under the anti-trust laws has yet to be determined. See Asher Hobson, "Farmers' Coöperative Associations," *American Economic Review,* Vol. XI (June, 1921), pp. 221–226. In this connection the following excerpt from an article in *The Market Reporter* of June 18, 1921, is of interest: "The growers in the valley [Imperial Valley] have again undertaken to restrict the movement of Ponys to market and have tentatively agreed that after June 9 no more Ponys will be offered for shipment. It is contended that the Pony melon lacks the quality of the Standards and since it is apparent that there will be sufficient Standards to meet the demand of the consuming public, the distributors are inclined to favor the move on the part of the growers."

crops. It is further claimed that the railroads, often financially interested in the business of the great "line" companies, have sometimes discriminated against the farmers by refusing to allow them to put in sidetracks and by failing to allot cars when they were most needed.

Bad Management.—The problem of securing competent managers has proved a fruitful source of difficulty. Farmers themselves have often been unable to direct the organization properly because of the lack of time or ability. They have been unwilling, moreover, to pay enough to hire a suitable manager.[42] In this connection, however, it should be remembered that the failure rate among independent merchants is also great. Education through failures, through state associations, coöperative publications, and the efforts of state colleges and of the United States Department of Agriculture, and more recently through the farm bureaus, is doing much to remove these difficulties.

Results.—The continued growth of these organizations seems to prove that they are a real benefit to their producer members.[43] Their development may be likened in many respects to the movement toward direct marketing of manufactured products. For coöperative associations are operated in the interest of the growers, just as direct marketing by manufacturers aims to control marketing in the producer's interest. Even in the matter of demand creation growers of specialties, such as the California and Florida citrus fruit growers and walnut growers and the Washington apple growers,

[42] The farmer's net cash income is usually small. A large part of his real income—house, use of his automobile, garden, etc.—he does not always consider a part of his income. The salary demanded by a good manager commonly seems to him, consequently, to be excessive.

[43] The latest discussion of the coöperative movement in the grain trade will be found in the *Report of the Federal Trade Commission on the Grain Trade,* Vol. I, 1920; among other recent discussions of coöperation in agriculture are part III of B. H. Hibbard, *Marketing Agricultural Products* (1921), and Chaps. XII, XIII, and XVIII of Theodore Macklin, *Efficient Marketing for Agriculture* (1921).

have a problem similar to that of many manufacturers. A very real gain, furthermore, has resulted from improved grading, which has brought improved agriculture, as well as increased prices. Farmer control has increased the likelihood of the growers receiving a price for their goods which is more nearly in accord with the market price. In many cases, farmers have established shipping associations where no independent organization existed but where there was a real need. In other cases, the business of the farmers has been largely concentrated in the hands of the coöperative. This has often reduced the expense of marketing because previously it had been divided among a number of competing dealers, each operating on a small scale and at a high cost.

II. Consumer Coöperation

History of the English Movement.—The modern coöperative movement on the part of consumers was begun in England in 1844 when a few workmen formed the Rochdale Society of Equitable Pioneers.[44] Starting with a single store and with a capital of £28 they bought a stock of goods and sold flour, butter, oatmeal, and sugar. The store did a small business and led a precarious life for some years, but it gradually achieved sufficient success to prompt the growth of a number of imitators in communities near by. By 1851 there were 150 such stores in the north of England and in Scotland. In 1852 the Rochdale pioneers entered the field of production and started to manufacture shoes and clothing. Gradually, either alone or in coöperation with other stores, other products were

[44] In the United States the Civil War disrupted many coöperative enterprises which were just being established. The Lowell Coöperative Association was established in 1876 and is still doing business. For a brief summary of the American movement and a more detailed statement of its present status among farmers, see O. B. Jesness and W. H. Kerr, *Coöperative Purchasing and Marketing Organizations among Farmers in the United States,* U. S. Department of Agriculture, Bul. No. 547 (1917).

manufactured and the variety of goods handled in the stores increased. Finally, in 1855 a wholesale department was started by the Rochdale store and some of its neighbors.

Coöperative Wholesaling.—In 1863 the North of England Coöperative Wholesale Society was established, the stock of which was held by forty-five local societies. This organization grew rapidly. Buying branches were established as the business grew and in 1873 the manufacture of biscuits and sweets was begun.

> "Today the Annual of the Coöperative Wholesale Society shows that it has five clothing factories, eight great flour mills, woolen cloth works, cocoa and chocolate works, soap, candle, glycerine, lard, starch and blue works, furniture, bedding and cartwrighting factories, printing, bookbinding and lithographic works, preserve, candied peel and pickle works and vinegar brewery, shirts, mantle, and underclothing factory, cap and umbrella making factories, and that it also manufactures overalls and shirts, drugs, pinafores and blouses, leather bags, cigars, and tobacco, flannels and blankets, corsets and hosiery, paints, varnish and colors, brushes and mats, hardware and tinplate, butter and margarine." [48]

Failures and Successes.—Many enterprises have failed, many stores have failed, but the movement has grown and prospered generally until in 1915 the Coöperative Wholesale Society had investments and assets of over $38,000,000; deposits and withdrawals in its banks were $1,347,678. A coöperative insurance company carries the fire insurance of the societies, a health insurance section has 165,000 members. The society now has factories, farms, plantations, and buying agents all over the world.

A similar society in Scotland has had a like growth and in some large undertakings the two concerns coöperate. But the movement is not confined to Great Britain. In one form or another it is found on the continent. There has been a remarkable growth of consumer coöperation in Germany, France,

[48] E. P. Harris, *Coöperation, The Hope of the Consumer* (1918), pp. 222-223.

Belgium, Denmark, and other European countries, a movement which appears to have been accelerated by the World War.[46] These continental selling organizations are like that in England, with local stores, central wholesale stores, and control of the production of important products. In some instances the coöperatives have coped with great combinations, bringing them to terms or establishing their own plants in successful competition. There are twenty-four wholesale societies in Europe. Of these there were five, each of which did an annual business of over $40,000,000 in 1916.[47]

The Nature of Consumer Coöperation.—As Harris puts it, the early coöperators desired (1) to get honest goods as cheaply as possible, (2) through the medium of a democratically controlled association, (3) operating in its purchases and sales as the representative of the buyer rather than of the seller.[48] They did not associate themselves for profit, as do the organizers of the ordinary mercantile establishment, but to procure low prices to the consumer.

Coöperation thus attempts to replace the "push" of the profit-seeking merchant by the "pull" of the consumer, and whereas the aim of the merchant is to make a high net profit, the coöperative store aims to procure good goods for its owners at low cost.[49] To assure consumer control of the store and

[46] The English Wholesale Society's business in 1917 amounted to over $300,000,000. See pamphlet by Albert Sonnichsen, *Consumers Coöperating During the War*, published by the Coöperative League of America, 2 West 13th Street, New York City, November, 1917.

[47] The story of the growth of European consumer coöperation is most interesting, and it has been presented to the world in excellent form by its many admirers. See E. P. Harris, *Coöperation, The Hope of the Consumer* (1918); Albert Sonnichsen, *Consumers' Coöperation* (1919); also various references mentioned in James Ford's "Annotated Bibliography of Consumers' Coöperation," *The Survey*, Vol. 39 (Feb. 9, 1917), pp. 517–18 (reprinted by the Coöperative League of America); and Sidney and Beatrice Webb, *The Consumers' Coöperative Movement* (1921).

[48] E. P. Harris, *op. cit.*, pp. 88–94.

[49] "The profits of merchandising which should be saved to the con-

to maintain interest in its activities the plan was early adopted of paying dividends on the amount of the purchases each individual coöperator made rather than on the amount of stock he owned. Furthermore, each shareholder is allowed but one vote no matter how many shares he may own. The market rate of interest is paid on the stock, and any surplus above that is divided on the basis of purchases. These, it will be seen, are the fundamental features of coöperation.

The prices at which goods are sold are substantially the same as are those in competing stores,[50] so that the consumer benefits financially only at the end of the year when the books are balanced, and necessary expenses paid, and reserves set up. What then remains of the surplus is divided on the basis of the patronage received.. This price policy has proved to be a strong feature of English coöperation. Because they sell at the same price as competing retail stores, the English coöperative societies avoid some of the opposition always felt toward price-cutters. But of greater importance is the fact that this policy gives the store a stronger financial position. It is not easy to tell in advance just what price will cover costs, nor is it wise to hew too close to the line. To have a surplus strengthens the store's financial structure and its credit as well. Then, again, there is a psychological advantage in the system. To save a penny here or two there seems of little moment, but to receive twenty, thirty, or fifty dollars as a patronage dividend once a year indicates more clearly the service of the store to its patron. It is also better for the

sumer are not so much as the downright wastes—wastes incident to competition, and wastes incurred by the present profit store to attract but not to serve consumers; all sales pushing, for instance, beyond legitimate enlightenment of the consumer, all expenses, in short, not necessarily incurred to bring goods to the consumer."—*Idem*, p. 63.

[50] See Bexell, Macpherson, and Kerr, *A Survey of Typical Coöperative Stores in the United States*, U. S. Department of Agriculture, Bul. No. 394 (1916), p. 11. The particular stores with which the English coöperatives compete are the "multiple stores" which correspond to our chain stores.

patron to receive his dividends in this way. A sum of such size to a family of small means has often been the nucleus for a respectable bank account, a home, or a government bond. Thrift is promoted.

A related feature of the English coöperative retail stores is the cash sale. The goods generally purchased are sold only for cash. This eliminates the investigation of credit incident to credit sales, as well as the loss through bad debts, and the consumer is himself protected from unthrifty habits—a service of no mean importance to the average laborer, of whom the coöperatives have been largely made up.[51]

Use of Surplus above Costs.—The normal practice of the English societies in the use of the surplus above costs is as follows: First come reserves for advertising the coöperative movement; next, reserves for educational facilities for the members and their families; then, for extensions and for the interest on the capital invested; and finally, the patronage dividend.[52]

To illustrate the financial features of consumers' coöperative stores the following example is quoted.[53] Assume that a store society with $10,000 capital has

Sold goods to its members in a year amounting to.......	$100,000
Made a gross profit of	25,000
Paid expenses of	15,000
And has what, in an independent store, would be a profit of	10,000

[51] Sales at competing retail prices and sales for cash are not fundamental features of consumer coöperation. In fact, many stores, particularly in America, endeavor to reduce prices. Important economies result from cash sales and since the aim of coöperation by consumers is usually to reduce prices, rather than to improve service, they prevail quite universally.

[52] Dividends are not distributed in Belgium but are used for certain group activities, including the *Maisons du Peuple,* popular social centers.

[53] E. P. Harris, *op. cit.,* p. 89 ff.

The distribution of gains might be as follows:

1. Reserve for education	$ 500
2. Other reserve	500
3. Interest on stock, 6%	600
4. Dividend on purchases, 8%	8,000

Total distributed	9,600
Surplus	400

A member who owned $50 in stock and had purchased goods to the amount of $500 would receive:

A dividend on his stock at 6%	$ 3
8% on purchases	40
Total	$43

Integration.—But the coöperative movement has not stopped with the local store. In the effort to save for the store's owner, the consumer, it became evident that there are great advantages to be obtained from controlling the channels through which the goods are procured. By combining their purchases, stores can buy in large enough quantities to procure better prices and they can afford to hire their own buyers—experts—to represent them in the producers' market. Even this has not sufficed, and the European movement has extended to the control of manufacturers, to agriculture, banking, insurance, and even to the ownership and operation of ocean-going vessels.[54]

Economic Aspects.—What are the economic advantages which are said to result from consumer coöperation? The coöperative store is operated in the interest of the consumer and is controlled by him. Its main activity is the purchase of goods for the consumer, whereas in the ordinary merchandise establishment goods are purchased when the consumer demands them or when the proprietor feels that he can make a profit from their resale. The profit element

[54] In the United States a considerable volume of purchasing is done by coöperative grain elevators and similar coöperative selling organizations for their patrons; see Jesness and Kerr, *op. cit.*

is lacking in the coöperative store, and, if the management is equally good, this is its economic strength. The retailer at his worst is tempted to shortweight, to overcharge, or to oversell in order to make a profit, but the coöperative store at its best aims to get what the consumer wants at the lowest possible price consistent with the quality and service desired. As the management is controlled by the consumer, the latter is represented in the producer's market by a skilled buyer with the consumer's point of view, working in the consumer's interest.

Any savings which result from doing away with the middleman's profit, through quantity discounts, direct purchases from producers, or from the elimination of expensive methods of demand creation, go to the consumer. This is important. For in the competitive market organization it is by no means certain that such gains benefit the consumer. The results of superior merchandising, whether wholesaling or retailing, are not likely to be passed on to the consumer to any greater degree than is necessary to keep his patronage and to meet competition. The remainder quite properly goes to swell the profits of the superior merchant.[55]

Some Selling Costs Cut Down.—It is undoubtedly possible for coöperative stores, especially when many units are working together, to save some of the selling costs of the competitive merchandising organization through removing "the din of aggressive advertising and salesmanship." Moreover, in so far as manufacture and wholesaling are integrated, all selling ef-

[55] A popular error which is of interest should be commented upon at this point. It is often assumed that the firms which make the highest profits in a given field are "profiteers" or "grafters," whereas in a competitive market it is in reality the high profit firms that are the greatest protection to the consumer. This is not on account of the high profits, but of what they indicate, namely, that the methods of such firms are superior to those of their competitors. It is they who are able and most likely to lower prices, whereas it is their high cost but low profit competitors, whose product is necessary to meet existing demands, that set the prices. See pp. 411–412.

fort directed toward wholesalers and retailers may be entirely replaced by a simple form of announcing new products with a description of what they are. Furthermore, the profit incentive which so frequently manifests itself in adulteration, underweight, overcharge,[56] is not so evident in the coöperative store, and such deceptions and tricks on the part of producers and their salesmen as prevail can be detected by the coöperative buyers when they are skilled in their task.[57] It is also likely that goods go by a more direct physical route from producer to consumer.

The "Coöperative Spirit."—But economic advantages do not seem to be the only means through which the coöperative movement has succeeded. There is another important factor in that intangible something which the exponents of the coöperative movement have sometimes called the "coöperative spirit," a spirit which appears to combine patience to wait for results with a willingness on the part of the coöperators to stick together through adversity. Where consumer coöperation has best succeeded it has had for its patrons thrifty persons, realizing the need for small savings, living in the same social stratum and with a common class feeling. This spirit as manifested in England has not been confined to the coöperators alone, but is also manifest on the part of the management.

> "Perhaps nothing impresses an American as more striking about this great business than the oft-cited fact that William Maxwell, who was for thirty years the president of the Scottish Wholesale, conducted its fifty-million-dollar-a-year business and never demanded a higher salary than $38 a week." [58]

[56] In the ordinary retail store some goods, such as staples, are commonly sold at cost or near, but many others with the values of which the consumer is not acquainted, are sold on large margins. Both the ethics and the desirability of this are now disputed points.

[57] That the efforts of coöperative managers to make a showing will tend in this direction of dishonest practice seems likely, and undoubtedly tends in some degree to offset the advantages mentioned. This, however, is less in evidence as the movement grows and prospers.

[58] E. P. Harris, *op. cit.*, p. 225.

Mr. Maxwell is said to have been only one of many who have received and do receive their recompense not in private profit but in public service.

Enthusiasts declare that it is the lack of this spirit which has been at the root of all coöperative failures. Impartial investigations of American coöperation have, however, unearthed more concrete reasons for the many failures of coöperation by consumers in the United States.

Weak Elements in American Consumer Coöperation.—

(1) The lack of any effective central organization through which to handle problems which could be solved through such an association has been one cause for failure.[59]

(2) The refusal of wholesale houses to sell the coöperatives has been another source of weakness.[60] Inasmuch as American coöperation has commonly gone no further than the organization of retail stores, dependent upon the usual channels for their products, they could not possibly expect to do more than save the net profit of the retailer, and possibly some of his costs for demand creation and for such services as the coöperators are willing to perform for themselves. In the case of small stores these savings and these profits are usually minor, not large enough to appeal to the average American as worth while.[61] With wholesalers refusing to sell, or discriminating against them, even this saving has often disappeared.

[59] Only recently has a national organization been attempted. The Coöperative League of America, 2 West Thirteenth Street, New York City, serves as "a National Association for Coöperative Unity and Education."

[60] Of approximately 60 stores reporting in 1916, "It is interesting to note that only 27 stores believed that they bought at the lowest price, while 11 said positively that they bought at a disadvantage. The reasons given were: (1) inability to take advantage of discounts, and (2) in a few cases, discrimination on the part of wholesale houses against the coöperative store."—Bexell, Macpherson, and Kerr, *op. cit.*, p. 14.

[61] At any rate this is usually accepted as true. The fact, however, that the retailer's share of the consumer price is usually in the neighborhood of one-third may in the end prove to be larger than necessary.

(3) In the United States there has been an absence of that social-economic status requiring small savings and of the consciousness on the part of large numbers of a social kinship, which appear to be so important to European coöperation. Without these, the movement has never achieved sufficient size or sympathy to carry on successfully those wholesaling and producing activities which have been so essential to the success of European coöperation, and from which alone could result those substantial savings which would make a wide appeal to American consumers. It seems more than possible that this spirit is now developing among large numbers of the classes which have found themselves pinched by the rising costs of living; and the bitter conflicts over wages and working conditions of recent months have undoubtedly strengthened such a feeling.[62]

A further consideration in this regard is the fact that American populations are less settled than are those of Europe. They move about too much to develop a close neighborhood feeling or a sufficient degree of confidence in their neighbors to make them willing to stake much in such an enterprise. Questions of nationality also enter in, and the mixture of races in many of our industrial centers, with its accompanying jealousies, has not been conducive to coöperative activity. Coöperative efforts seem to thrive best where there is a greater community of interest. Thus the Finns and other foreign peoples in sections of Massachusetts, Michigan, Northern Wisconsin, and Minnesota have developed successful coöperative stores. This may also account for the fact that many coöperative stores in the United States are found in small towns and are largely patronized by farmers.

(4) Another weakness of consumer coöperation in the United States is the failure of Americans to feel the need for the small savings which result from coöperation. In this connection, it should be said that American coöperative stores

[62] Several labor organizations have undertaken coöperative enterprises.

have until recently tried to show immediate results through lowered retail prices. The very small saving usually possible on an individual purchase has been disappointing to the coöperator.

(5) There is frequently a lack of business knowledge on the part of the coöperators. This has proved to be the greatest cause of failure. In this last connection, a recent government investigation has shown that the "precariousness" of coöperative mercantile business is due to inefficient accounting and auditing more than to any other single cause.[63]

(6) The handicapping of American stores in the past through lack of laws recognizing the validity of the coöperative features of one vote and the patronage dividend has also been a cause for failure. Organized as coöperators they have frequently lost their coöperative nature soon after their organization and have become regular commercial organizations.

[63] Bexell, Macpherson, and Kerr, *op. cit.*, p. 16.

CHAPTER XIV

THE ELIMINATION OF MIDDLEMEN

I

The attacks on "profiteering" which arose out of the high prices incident to the World War have re-emphasized the recurrent discussions of the "enormous profits" of middlemen, of the wastes of the existing distributive system, and of proposals for its reform[1] This type of discussion is always present, but it becomes more insistent during periods of rising prices. Thus, for some years past, agitation for the "elimination of middlemen" has been carried on from the standpoint of the general consumer and of the farmer, hitherto the two great unorganized groups in the market. Much of this agitation has been confined to the distribution of agricultural products. But unnoticed by the public and even opposed by it when connected with the "trust movement," there has developed a very definite elimination of middlemen in the marketing of manufactured products—a movement which has perhaps gone further in this country than have the similar movements of farmers and consumers. Moreover, although the public has evidenced a greater interest in products intended for the retail trade, the greatest amount of "direct" trading is being done with production goods, equipment, and supplies[2]—products which are either raw materials for manufacture, semi-manufactured raw materials, or finished products intended to be

[1] This chapter summarizes parts of previous chapters in order to bring together the facts bearing on this query. It thus serves as a partial summary of what has gone before.

[2] See Chaps. VI and X.

used in further production.[3] Wool, cotton, and rubber are examples of the first class of products; yarn, iron ore, and automobile parts are representative of the second; and machinery is a good example of the third.

Definition and Limitation.—There are many types of middlemen, operating in many different ways and under varied conditions, and the question of their elimination assumes a variety of forms not usually appreciated by the uninitiated. Some definition and limitation of the subject, therefore, will clarify the discussion.

The bank, the railroad, the insurance company, and other functional agencies are, in a sense, middlemen. But the middlemen in question are of the two classes previously considered:[4] those who take title to goods for the purpose of resale; and the functional middlemen of purchase and sale who do not take title, but who assist directly in bringing about the transfer of title.[5]

The present discussion will be further limited, since two distinct problems arise:

1. There may be too many independent middlemen operating between producer and consumer.
2. There may be too many middlemen of each type.

[3] See pp. 7–9.

[4] Pp. 5–7.

[5] The following quotation describes the first type of middlemen as they operated before the more recent changes that have taken place in market organization:

"Each took the risk of destruction of the goods while he held title. Each took the risk of credit losses. Each took a share in the transportation of the goods along the route from the producer's stock room to the hands of the consumers. Each took a part in financing the entire operation. Each had a part in the selling, disposing of the goods he purchased to succeeding middlemen and finally to the consumer. And each finally took a part in assembling, assorting, and re-shipping the goods to make them physically available to the consumer."—A. W. Shaw, "Some Problems in Market Distribution," *Quarterly Journal of Economics,* Vol. XXVI (1912), p. 731. (Republished in book form under the same title.)

It is contended that some products go through the hands of more independent firms than their most effective distribution requires. This is the situation most often in mind in current discussions. But although this is more widely discussed, it is not always the most important aspect of the question of eliminating middlemen. Many careful students hold that there are too many individual firms engaged in the work of each step in marketing—too many country shippers, commission men, brokers, jobbers, and retailers. This involves the question of determining what scale of operation is most effective. No attempt will be made at this point to discuss this second problem.[6]

Nature of Criticism.—In the consideration of the first problem there are two types of criticism of the middleman system which are not always clearly distinguished. It is held that the cost of marketing is greater than it should be, or that the service is inferior, because the goods go through "too many hands." And it is further maintained that so much machinery makes it possible, somehow, for some or all of the links in the chain to "take out" a larger profit than their service warrants. Consequently, it is asserted that this profit would be saved if more "direct" methods of buying and selling prevailed. Two important classes of argument are thus advanced in favor of eliminating some of these successive middlemen. It is urged (1) that better service will follow at the same or a lower cost, or that lower cost will prevail for the same or better service; and it is also asserted (2) that profits to the middlemen will be reduced and the profit accrue to producer or consumer in the form of higher prices to the former and lower prices to the latter.[7]

[6] It will be discussed in Chap. XXVI.

[7] When marketing processes are combined by a middleman, any resulting reduction in the profits of the integrated steps is likely to benefit, in part at least, the middlemen absorbing them rather than the producer or consumer. This will be true unless competition forces prices up, or down.

Who Can Eliminate Middlemen?—Middlemen may be eliminated by the action of producers, consumers, or other middlemen. The farmer who sells his produce to the consumer has passed over one or more possible middlemen; the manufacturer who utilizes his own organization for reaching the jobber has eliminated an agent between himself and the jobber, and if he sells to the retailer he has also eliminated the jobber, and if he sells to the consumer, he has gone around the retail dealer as well.[8] The consumer who buys from the farmer, the coöperative association which runs a retail store, and the department store, chain store, or mail order house which buys from the manufacturer, as well as the jobber who runs his own retail stores—these have all eliminated middlemen. They are themselves, in other words, performing the functions which would otherwise be performed by independent market agencies. Again, the market functions may be performed "directly" only in part. Manufacturers of staple consumption goods, in particular, ordinarily utilize the services of the jobber and the retailer to perform some of the market activities necessary to the distribution of their products, and utilize their own organization for the remainder.[9]

In many cases it is not quite correct to say that a middleman has been "eliminated"; for the particular farmer or manufacturer may never have sold through a middleman. But the determination to sell direct involves a choice of methods.[10] It involves, consequently, much the same result in method and

[8] It should be kept in mind that many manufactured products are not made for immediate consumption, but are sold to other manufacturers for further change or for use in making other products.

[9] See Chaps. VIII and X.

[10] At this point it will lead to a better understanding of the points at issue to review the marketing functions. See Chaps. I and II. In his article "Some Problems in Market Distribution," A. W. Shaw calls them "functions of middlemen," *Quarterly Journal of Economics*, Vol. XXVI (1912), p. 731.

in market influence as though middlemen had been used earlier and then discarded.[11]

The actual status of the middlemen in different types of marketing has been discussed from time to time.[12] It remains to summarize the conclusions of previous chapters in so far as they bear on this subject and to add such new data and draw such general conclusions as seem warranted.

II

The Situation in the Agricultural Market.—For years there have been more or less insistent demands for the elimination of middlemen from the agricultural market—demands that the product go more "direct" from producer to consumer. The statement has been made and widely circulated that the farmer receives on the average but 35 per cent (or some other small per cent) of the retail price of his product.[13] Examples have been frequently quoted, as typical of all kinds of products, of farmers who have received seventy-five cents for a barrel of apples for which the consumer paid as high as four dollars. The conclusion commonly drawn from such statements is, of course, that either some one is getting enormous

[11] This is not entirely true. For example, the antagonism felt by former distributors would be lacking, and if there were no recognized dealers in this product, dealer competition would be at a minimum.

[12] The elimination of middlemen in the agricultural market by farmers as well as elimination of middlemen by consumers, was discussed in the last chapter. The elimination of middlemen by large retail middlemen was covered in Chap. XII, and some of the factors in the use of middlemen in distributing manufactured goods were discussed in Chaps. VII, VIII, IX and X.

[13] The following table of percentages is taken from L. D. H. Weld's investigation of Minnesota prices, "Market Distribution" in Bulletin No. 4, *University of Minnesota Studies in the Social Sciences,* pp. 7–9. It shows the margin "taken out" for distribution in a much more favorable light than do many popular statements and propagandist remarks.

profits, or else that there is gross inefficiency in agricultural distribution. Investigation shows that, in general, however, dealer margins for staple products are usually very much less than such figures seem to indicate, and that the marketing of agricultural products is surprisingly efficient in view of the problems which are involved.[14] On the other hand, it is equally true that some middlemen do reap enormous profits

[13] *Note continued.*

Product	*Value of Commodity Marketed*	*Per Cent of Retail Price Received by Farmer*
Milk	$7,000,000	45
Cream	1,400,000	40
Butter fat	11,000,000	75
Dairy butter	3,600,000	75
Poultry	1,800,000	45
Eggs	6,200,000	69
Live stock	34,000,000	55
Grains	56,000,000	70
Potatoes	3,000,000	50
Other vegetables	1,000,000	30
Fruits	200,000	30

[14] See L. D. H. Weld, *The Marketing of Farm Products,* especially Chaps. IV, IX, and X. Some figures popularly quoted contrast the price received by the farmer with the price of the goods on reaching the consumer after manufacture, implying that the difference is the cost of distribution. Such comparisons are always erroneous because they include the cost of manufacture in the marketing cost. Furthermore, many such comparisons have been made on a volume basis. Since much of the original raw material is not contained in the final product this comparison is also erroneous.

The margins of various dealers in the farm market are shown on p. 510. A more detailed table, which covers the cost of marketing wheat, follows. This data appeared first in Kerr and Weld, "Prices of Wheat in Kansas City, etc.," *House Document 1271,* 63d Congress, 3d Session, p. 27. It will be found in Weld, *The Marketing of Farm Products,* p. 212. Note that of the 26.5 cents spread between the farmer's price and the Philadelphia price, 21.8 cents was paid out for railway freight. Under the rates now prevailing this is both relatively and absolutely greater.

at times, that dishonest practices are found, and that gross inefficiency is sometimes present.[15]

Direct Buying by Manufacturers.—It was shown in Chapter VI that manufacturers often buy their raw materials directly from the source of supply. In fact, it is probably more common for manufacturers to buy their important raw materials immediately from the producers than to sell their final product to the consumer, or even to the retailer, through their own sales organization. And it has been shown that some go so far as to control or even own the source of supply of their raw material. Large growers and large buyers of agricultural products generally tend to go over the head of one or more of the middlemen of the usual channel of distribution.[16] Manufacturers of mechanical devices buy important parts and equipment, which they do not make themselves, al-

[14] *Note continued.*

	Cents per Bushel
Price received by farmer in Kansas	87.0
Margin taken by country elevator	3.0
Freight rate to Kansas City	6.2
Inspection, weighing, and interest on draft	.25
Commission	1.0
Price paid by shipper in Kansas City	97.45
Freight rate, Kansas City to Philadelphia	15.6
Mixing in Kansas City elevator	.25
Exchange	.20
Overhead expense of shipper	.375
Net profit of shipper	.625
Price, delivered in Philadelphia	114.500

[15] The "middleman" most railed against is probably the jobber. Yet his margin of profit is usually very low and his efficiency very great. On the other hand, the retailer's margin is very great and his efficiency very low. See Chaps. XI and XXV; also L. D. H. Weld, *The Marketing of Farm Products*, Chaps. IV and VI.

[16] "In a few cases eastern mills buy, in the 'fleece' wool sections, direct from representatives who collect small lots for them. Occasionally, an eastern merchant may attempt to secure his supply direct from the farmers, but this method is expensive, slow, and pays only under exceptional circumstances."—P. T. Cherington, *The Wool Industry*, p. 61.

most exclusively through their own buyers or through the salesmen of the manufacturers. In fact, in most cases involving the sale of production goods to manufacturers in which the number of producers is small, or the number of manufacturing concerns is small, and particularly when the volume of business is large, there is a probability that direct connections will be established and that consequently the services of the middlemen will not prove essential.[17]

Many raw materials and semi-manufactured products are, nevertheless, better handled through middlemen, and not always for reasons of immediate economy. This is true, for example, in the textile trade. Thus Copeland after relating that "the pound of cotton will pay tribute to two Liverpool brokers, to a yarn agent and merchant, to a cloth agent, converter, and merchant, and finally to a wholesaler and retailer," says:

> "The advantage accruing from this multiplicity of middlemen is not inexpensiveness but flexibility. The tentacles of the Manchester trade reach out to all corners of the world, and whatever form of manufactured cotton is sought, whatever accomodation is desired, some one can be found in Manchester ready to accept the commission. Of all the assets which make it possible for the cotton industry to attain its largest dimensions in a country which does not produce the raw material, and which consumes only ten or twenty per cent of the yarn and cloth manufactured in its mills, none is more significant than the adaptability of the commercial organization." [18]

Direct Marketing of Manufactured Products.—It was shown in Chapter X that with their organizations growing in size and financial strength, and with the problems of organization for production nearer solution, many manufacturers have now time and financial resources to devote to the sale and distribution of their product. As a consequence of

[17] See pp. 286–287.

[18] M. T. Copeland, *The Cotton Manufacturing Industry of the United States*, p. 371.

this, and of the pressure of increasing competition, numerous establishments have taken over, in whole or in part, the distribution of their products as well as the purchase of their raw materials. Manufacturers have, in fact, assumed charge of the sale of their products to such an extent that there is today a large and growing part of the selling field which is either in a state of transition or which has already passed from the control of wholesale middlemen to that of the manufacturers. There is, at present, not only a great pressure on manufacturers to create a demand for their products, but that pressure is continuous if they would hold the demand that already exists and the new demand which they may create.

Jobbers, likewise, often reach out and buy directly from producers products which are commonly handled by middlemen between producers and jobbers, so that the services of selling and purchasing agents are now frequently dispensed with by the larger jobbers. And large retailers generally endeavor to buy directly from producers. This may be accomplished through their ability to order in large enough quantities to afford an inducement to the manufacturer to sell directly to them at wholesale prices.[19] Or a store may establish a wholesale department in order to obtain wholesale prices. Large chain stores usually buy directly and have their own jobbing organizations. Smaller stores frequently combine their purchases and order in large amounts directly from producers, or form a wholesale organization of their own.

The chief efforts of farmers and of final consumers to eliminate middlemen have taken the form of association into coöperative organizations. In addition to this, individual producers and consumers do some direct marketing in their use of public markets, the express service, and parcel post.

[19] Sometimes prices are based entirely on the quantity bought, regardless of whether the purchaser is a retailer or a jobber.

III

The Arguments for Elimination.—Much of the argument for eliminating middlemen arises from the false notion that the fewer the distinct agencies that handle a product, the more quickly, efficiently, and cheaply it can be delivered to the consumer.[20] In production it is not disputed that the division of labor leads to better and cheaper production. But many fail to realize that the advantages of specialization and division of labor apply in marketing as well as in production.[21] At least they are not convinced that this is true. Of course, few argue that banking, transportation, and insurance are not better performed under existing specialized methods than would be the case if those services were performed by producer or consumer. But that equal efficiency results from the presence of specialized country shippers, jobbers, selling agents, and retailers is not so commonly accepted. Yet this is true, and it is unconsciously recognized by those who appear most anxious to correct the existing system.

When farmers, for example, eliminate a middleman by means of a coöperative association they themselves perform, through a specialized organization, the very functions he performed. When an association is formed at a local market where no middleman exists, another middleman is, in effect, added. An organization, such as the Cali-

[20] Much of the attack upon the middleman smacks of the ideas of the middle ages and the early modern era when it was quite generally held that merchants were "unproductive", and so parasitic, and given to deceit and to dishonest practices generally. For an interesting collection of these early views see Nystrom, *Economics of Retailing,* Chap. I.

[21] For the best presentation of this argument in the case of the agricultural middleman, see L. D. H. Weld, *The Marketing of Farm Products,* Chap. I, and other parts of the book in which the problem is discussed. See also E. G. Nourse, *The Chicago Produce Market* (1918), pp. 176–178, and H. Clay, *Economics for the General Reader* (American edition, 1918), pp. 47–53, 74–76, 82.

fornia Fruit Growers' Exchange, performs the same functions as does an independent agency. When a manufacturer eliminates a jobber he must perform the jobbing function himself, and when consumers eliminate a retailer or even go further and eliminate the jobber they themselves perform the dealer's functions.[22] The farmers' organization is directly supervised by a manager and committee, who are supposed to be, or to become, specialists and experts in marketing; the manufacturer has his special selling organization, and establishes branch selling houses and storage facilities; and so, likewise, consumers duplicate existing machinery when they buy "directly." Even individual farmers who market directly must give much time and attention to the performance of their market activities, and take over the work of middlemen.

At the root of much misunderstanding is a general failure to realize that the work of marketing has to be performed and that it usually involves labor as difficult and as expensive as the work of production. A commodity is only half produced, in fact, when it is harvested or manufactured. Consequently, the statement that the services of a middleman have been eliminated sometimes proves misleading. For many persons assume therefrom that the functions have not which that middleman performed have likewise been done away with. But this is not the case. When, for example, a manufacturer sells directly to the retail trade, it is necessary for him to create the demand for his product through the use of advertising or salesmanship, or both; whereas under the orthodox system he depends upon the jobber or the selling house for this service. Again, as was the case to a large degree after America entered the World War, when the pressure in a given trade is on the purchaser, it means that the buyer who goes around the middleman must himself take over the buying and assembling functions of the middleman.

[22] The consumers even go further in England and "eliminate" the manufacturer in some cases, and even the farmer. See p. 265.

Who Profits from "Elimination"?—Since middlemen may be passed over by producers, by consumers, or by other middlemen, the effect of this elimination upon the various parties to the market is of interest. The objects, for example, of producer and consumer coöperation are to increase the farmers' price, or to lower prices to the consumer, through reducing in each case the spread between producers' and consumers' prices.[23] The two objects may well be antagonistic. Farmers' organizations which eliminate middlemen are likely to assume that existing market prices will continue to prevail. They do not anticipate that the consumer price will be lowered, but rather that their share of that price will be greater. A little different aspect of this attitude is shown in the attempts of some farmers' organizations to hold back or even to destroy surplus crops in years of heavy yields, to reduce acreage when there are prospects of a falling price, and in their opposition to the free importation of competing agricultural products. Ultimate consumers, on the other hand, believe they are benefited by large home crops, and by large importations of foreign crops which depress the price of the commodities they consume. And when a middleman "goes around" another middleman, his chief interest is to gain for himself any expense or profit which is saved, or any market control which may result. These facts indicate that any good results from the elimination of middlemen, do not necessarily accrue to both producer and final consumer. Either may absorb, at least temporarily, any "profits" or "saving" that result without passing them on to or dividing them with the other. It is possible likewise that the gain may be absorbed by a middleman.

This, of course, should not be construed as an argument

[23] The "spread" is the difference between the price received by the seller and the price which he pays. It thus refers to the difference that results from the product going through the hands of one middleman, such as the retailer. It may also refer to the total difference between the price paid to the producer and the price paid by the consumer.

against the improvement of methods where that is possible, and it is not an argument against reducing any undue profits reaped by middlemen. Such ends are just as desirable as it is to avoid waste in consumption, to prevent inefficiency and incompetence in production, to curtail combinations of buyers which force down prices, or to reduce inordinate profits reaped by producers. In the end, competition will usually cause the savings which may result from superior methods to benefit the producer and consumer.

The Importance of Service.—In the discussion of the use of middlemen as it relates to the costs of distribution, there is a rather common failure to consider the service performed. Much of the excessive cost of distribution can be attributed to the prevalence in the retail trade of small neighborhood stores, free deliveries, returns, allowances, and the granting of credit. Conditions of this kind have their effect throughout the whole distributive organization. The great variety of products found in some lines of trade caters to the consumer's demand for something new and different. This desire of the consumer for new and varied products practically forces the whole trade to provide them. The failure of one dealer to do so is quickly capitalized by his competitors. Provision must be made by manufacturers and wholesalers for delivering small quantities of goods at frequent intervals, in order to avoid loss through style changes, change of prices, or deterioration of perishable commodities. This causes excessive sales and buying effort and costly transportation and delivery.

The Problem Is One of the Control of Specialization.—It appears that the crux of the middleman problem is not whether the middleman shall be eliminated as a middleman, but rather whether marketing can best be performed by independent specialized marketing agencies or by integrated organizations. That is, should production be integrated with marketing, one marketing agency integrated with another, and consumption integrated with marketing? That manufactur-

ers' marketing tends toward integration seems beyond dispute, although, as has been shown, there are many conditions which may definitely retard the movement. The trend has not been so evident in agricultural marketing because the smaller size of the units which buy and sell makes it more difficult, and because the problem of demand creation, which is often a compelling motive leading to the manufacturer's desire to control his market, is not so important with agricultural products. But with the recent development of coöperative marketing of farm products and particularly the development of coöperative federation, the trend is evidenced in agriculture.

When integration does take place, specialization is not done away with. Separate specialized efforts are then coördinated by the control of a single management, rather than by market forces acting upon independent factors. And there may well be some question whether such integration of marketing steps, by any means leads to lower prices even though it may tend to greater market control by the integrating party.[24]

Specialization and Integration.—Marketing seems to be developing much as production has developed. That is, specialization and division of labor take two forms: (1) they may lead to a high degree of division of processes among independent producers and middlemen, as in the textile trade; or (2) they may be brought about under the integration of specialized units, as in the steel industry. The technical basis for each is the same, but the control is divided in the one case, and unified in the other. And whereas the large producer or consumer can perhaps profitably operate his own sales or buying organization, his smaller neighbor may find this out of the question. The advantages of specialization inhere in either case. The difference is in the method of control. Independent agencies endeavor to control their activities in such a manner as to profit from their merchandising operations. When these activities are integrated with production, consumption, or, in the case of middlemen, with the operations

[24] See pp. 177–181.

of other middlemen, the integrating party endeavors to control the operations so as to forward its own primary activities.

Fundamental Basis for Control.—Such unified control is based fundamentally on the possibility of securing better service, or on the hope that the integrated service may be secured at a lower cost. This lower cost may result from a more economical performance of the service or from securing the profits made by the independent organizations.

Other things being equal, each producer is likely to prefer to market his own product when his profits depend upon successful selling. But, of course, other things are by no means equal, and in many instances the producer is lacking in ability, in knowledge of the market, or in capital. But when competition is very keen, or when the product is a specialty for which a demand must be created—conditions which exist throughout much of the field of manufacture and of merchandising and with a few agricultural products—this desire may become a necessity. It may be necessary to control a part of the market for the product, or it may be necessary to control the source of a raw material. Likewise, where middlemen have proved dishonest, or where none are available, as often occurs in the marketing of farm products, the necessity for direct action by the producer becomes evident.

Industrial Conditions Affect Market Integration.—Industrial conditions may also prove to be important elements in the decision. The development of transportation and communication, for example, has brought producers and consumers nearer together and has thereby reduced the need for market intermediaries. The introduction of "standard equipment" on automobiles—lights, windshields, tires, and other equipment—largely reduced the need to retail them and thereby to job them. The growth of chain stores has forced many competing retail firms to adopt cash-and-carry methods, and to form central buying organizations. Increased production of oranges developed a problem of demand creation for California and Florida growers. Perishable products are quite commonly

marketed "directly" because independent middlemen do not give satisfactory service. It is also true that many products carry with their sale the necessity of giving "service," i. e., repairs, renewals, equipment, supplies, instruction in the use of the product. Among these are farm machinery, tractors, automobiles, and adding machines. Service of this kind is usually most satisfactorily performed by the producer. This leads to the substitution of branch houses controlled by the manufacturer for the ordinary jobber, with a resulting close contact and close control over retail outlets. Finally, producers or buyers may become financially strong, and since this is essential to direct purchase and sale it may cause a complete reversal of the former policy.

Conditions Which Make Integration Feasible.—Conditions like those which have been outlined may make direct marketing desirable. But the desire cannot be fulfilled unless the particular project is feasible. To be feasible, the integrated service must be performed in a satisfactory manner at a cost which does not add too much to the selling price. For if the price is too high the consumer will not buy, because he cannot be made to desire the merchandise enough to do so, particularly if competing products are sold at a lower price. The feasibility of direct marketing is, therefore, basically a matter of cost. The cost must not be so far increased as to offset the advantages gained. If, on the other hand, costs are lowered, a definite advantage results.

One of the most important conditions determining the cost of direct marketing is the size of the transactions between buyer and seller. If the volume of individual transactions is large, direct dealing may prove practical. This point was touched upon in discussing the jobber's services.[25] If the buyer takes large quantities of a product, the manufacturer can often afford the expense of direct sale, and the buyer likewise can afford the trouble and expense of direct purchase. The money value of the business must be great enough

[25] See Chap. VIII.

to absorb the expense of direct sale. If the physical volume will permit, direct shipment is also practicable.

Manufacturers buying raw materials commonly purchase in sufficient volume to warrant both direct shipment and direct sale. Retailers who handle a narrow line of goods, such as shoes, clothing, automobiles, and farm implements, can usually buy directly with economy. When the sale of individual items is small, volume is sometimes achieved by selling a number of related articles. This is done by such firms as the National Biscuit Company, Heinz, the meat packers, and the International Harvester Company. Again, even though individual sales may be small, if enough buyers are concentrated in a given district the same results may be achieved. Thus, many manufacturers of grocery and drug products can market to retailers because of the density of sales, and manufacturers can sometimes market directly in a large city, although they find the cost prohibitive in sparsely settled areas. But if producers are small and, consequently, cannot sell in large quantities, or over wide territories, some medium for collecting products into central reservoirs is necessary. This is true whether the goods be purchased in the end in small quantities or in large.[26] Again, if purchasers cannot buy in large quantities, some agency for dispersion is necessary. If producers and consumers are both small, both concentration and dispersion are ordinarily necessary, and independent middlemen usually arise to perform these functions.

Scale of Production and Direct Marketing.—The points discussed in the last paragraph seem to show that the prevailing tendency in production in an industry indicates in some degree the prevailing type of distribution in that industry. In agriculture, for example, and in certain fields of manufacture, small producing units and small independent middlemen prevail. With farm machinery, mineral oil, and steel, large scale production is the rule, and here, therefore, a high degree of direct marketing is found. Quantity pro-

[26] See pp. 29–30, 39–42, 61–65, 90–91, 97, 153–155.

duction is not, however, a sure criterion of direct marketing. Sugar is marketed through middlemen, although the raw materials are usually bought direct; copper is likewise marketed through middlemen. In both instances, large scale manufacture is the rule. But in each case, quality is determinable through scientific analysis; the market price for given grades is uniform; and higgling of any kind is almost eliminated.[27] No "touting" of goods can avail under such conditions, and "selling points" are determined in the laboratory by the buyer himself. Selling such goods consists merely in bringing buyer and seller together.

Many farmers sell direct to consumers or retailers, and sometimes, as in the case of the California Fruit Growers' Exchange, the whole process of distribution is in a large measure controlled by the growers. But direct sale is an exception to the general rule, arising out of purely local conditions, such as proximity to a public market, or to the store of the retailer. In the case of the fruit growers special conditions previously discussed are at work,[28] and, furthermore, the small producing units are combined into a large marketing federation. It is this organization, not the individual growers, which does the marketing.

Y

Importance of Individual Characteristics.—Just as large scale production seems likely to hold the field in some industries and small scale production in others, and just as neither type has yet proved superior in other fields, so in distribution various types and scales of size and various degrees of integration are found. Even in the distribution of the same product under substantially similar conditions great variations prevail. No general conclusions of themselves are sufficient to account for this. The reason in many cases seems to be founded upon the characteristics of the individual business enterprise.

[27] It also appears that the sales agencies are in reality often closely controlled by the producer.

[28] See pp. 252–253.

A firm with large financial resources may be able to undertake a direct campaign, while its financially weaker competitor is unable to raise the necessary funds, or at best is unable to withstand the financial losses in case of failure. Furthermore, the individual capacity and experience of those in entrepreneurial and managerial positions vary greatly. In one enterprise, those in responsible positions may be primarily trained in production and know little or nothing of distribution. They may realize their limitations, or, not doing so, fail in the effort to extend the scope of their distributive machinery. In a competing concern, the opposite may be the situation. Finally, it seems often to be the case that many a manager's capacity to oversee a business is soon reached. For him, a large distributive plan would be fatal. With such large variations in the capacity and training of business men it is evident that under the same conditions there may result very different solutions of a market problem.

"Profiteering."—In times of a rising market, middlemen who buy at the lower prices can resell at higher prices, so that the cry of profiteering is particularly strong during a period of rising prices. Of course, when prices fall, middlemen are likely to lose.[29] Merchants, manufacturers, farmers, and landlords are alike in reaping large profits on a rising market: if they hold goods for any time, the profits result from high prices; they, individually, and even as classes, do not cause them. The manufacturer or merchant, for example, who avoids "profiteering" by selling at cost in addition to a reasonable profit leaves the way open for the next owner to "profiteer." Seldom does the final consumer benefit.

[29] Greater losses are probably borne by producers than by merchants. Because the goods are commonly longer in the process of production than of merchandising the time element is of greater importance. Furthermore, the finished goods of the merchant can usually be liquidated more rapidly than can the producers' high priced inventories of raw materials and supplies. Likewise, unless the merchant speculates, the producer is likely to benefit more from rising prices.

Final Conclusions.—(1) The general advantages of the middleman system are the advantages of specialization and of division of labor by independent units. Such specialization tends toward more skillful and more economical operation. But it has been shown that these advantages are not necessarily lost when marketing steps are absorbed by producers, consumers, or other middlemen. The only change may be the substitution of a hired specialist for the independent specialist. Efforts to do away with middlemen may, furthermore, simply add to existing market machinery. When a department store, a chain store, or a mail order house begins to buy directly of manufacturers the elimination of a jobber does not usually result. None of the existing jobbers are thereby forced to retire. It follows rather that a new jobbing organization—within the organization of the integrating dealer—has been added to those already existing. The cost of wholesaling in general may be thereby increased. For the scale on which jobbing is carried on would be made smaller with the introduction of more wholesale organizations, old style jobbers might be left with less profitable lines, and hired managers, possibly less efficient than the independent entrepreneur, would be used in the new organization.[30]

(2) It is a false idea that the fewer the hands a product passes through in going to market, the lower will be the cost of distribution, and hence, the lower, final prices may be. This is particularly untrue when integration results in sales and deliveries which are smaller in value or in physical volume than were those made by the independent middleman. It was shown, for example, in Chapter VIII that the grocery jobber can sell and deliver more cheaply to grocers than can the manufacturer of a grocery product which is sold in small amounts. Since a manufacturer usually sells fewer products than the competing middleman whom he is "going around", a larger relative fixed investment is likely to be required,

[30] But see pp. 150, 152, Tables V and VI.

and he is likely to have larger current expenses for selling, storage, and delivery. His market risks will also be greater, for they extend over a longer time than formerly, and they must be borne by a single product or a small line, whereas the jobber's risk is divided over a wider range of products. This is true unless it is offset by superior knowledge of the market, so as to forecast important changes in demand, or unless the direct marketing creates a large consumer demand for the product.

(3) On the other hand, when integrated organizations handle products sold in large volume it may well be that direct economies result. In the first place, the cost of holding stocks is possibly lowered. Because of a close contact with, and analysis of, the specialized market in which he sells, a manufacturer or large merchant may be able to judge the demand with great accuracy. He may carry smaller stocks than would be necessary for independent dealers, because of his greater knowledge of the market and of the greater mobility of his stocks.[31] Perishable products are, furthermore, likely to be more economically stored in specialized warehouses operated by the interested producer.

(4) Again, fewer changes of title take place when integrated marketing prevails. The cost of buying and selling and of financing and bookkeeping which accompanies each successive change of title is very large. The expense becomes greater if the goods themselves are moved. When the number of independent steps is cut down, these costs are probably less.

(5) Low transportation rates for large shipments on the one hand, and the demand of buyers for small amounts delivered on short notice, on the other hand, necessitate a wholesale and a retail service for the physical distribution of many products. In so far as these factors are important this service can generally be performed with greater

[31] This last point was mentioned also in discussing large retail organizations in Chap. XII.

economy by independent retailers and jobbers who stock the products of several producers than by the producers themselves.

(6) Finally, when goods are sold on the basis of standards easily determined by the buyer, the opportunity for control of the market by means of demand creation on the part of individual producers is practically nullified. In such cases, one of the strongest motives impelling producers to market directly is eliminated, namely, the desire to create consumer acceptance, or demand, for their particular product by means of their own sales efforts.

Summary.—So long as there are small producers who cannot distribute their own products economically; and so long as there are large producers inadequately supplied with capital to carry on extensive distributive activities, or handling too limited a "line" to make direct marketing feasible; and so long as there are small retailers who find it difficult to get in direct contact with their numerous sources of supply, or with whom it does not pay the producer to get into direct contact; or so long as ultimate consumers find more valuable use for their time than to talk with, correspond with, or read the advertisements of, the hundreds of producers whose goods they consume—just so long the middleman is likely to continue to function as an independent unit and to perform services useful to society as well as to the factors in the distributive process.[32]

[32] Seeming exceptions to this conclusion are the growth of coöperative purchasing associations of retailers and consumers and coöperative selling associations of small producers. But these are really merely different aspects of the large scale methods already mentioned. They are combinations of small market units. If such systems should largely prevail, if producers on the one hand and consumers on the other should organize into great associations, the elimination of middlemen would indeed grow apace. In so far as such organizations curb undue competition among producers and among middlemen, and in so far as they eliminate undue demands for service on the part of the consumer, a real saving in costs seems to result.

CHAPTER XV

PHYSICAL DISTRIBUTION

I. Transportation

Introduction: Importance of Transportation.—Many of the evils and much of the strength of our market system have their origin in transportation methods. Slow deliveries and inadequate equipment cause products to deteriorate before reaching their market, and slow deliveries necessitate the maintenance of excessive inventories of stock and materials by stores and factories.[1] Rapid, efficient, cheap transportation is essential to effective distribution.

One of the most important aspects of transportation is the effect of transportation rates upon the expense of marketing. As an integral part of the necessary cost of marketing, these rates affect the prices at which products are sold. And, as an essential part of the cost of marketing they largely determine in what markets the products of a particular section can be sold. Transportation is likewise of importance in determining the location of trade centers. The geographical situation of a city with natural transportation facilities at a strategic point between areas of production and consumption

[1] "Mr. Ford, owning his own railroad and insuring prompt freight movement, cut down his investment in materials on hand by no less than $28,000,000!"—Judson C. Williver, "Henry Ford, Dreamer and Worker," *Review of Reviews*, Nov., 1921, p. 488.

During the World War many retailers, because of the uncertain and slow deliveries, kept twice the stock on hand in some lines that they had before the war. This was true even when the general shortage of supplies was not felt.

practically assures that city a place of importance as a commercial center. Thus,

"Denver's geographical location at the foot of the Rocky Mountains, near three of the natural passways to the Far West followed by the Union Pacific, the Denver and Rio Grande, and the Santa Fe railroads, has made it a distributing-point for a large hinterland."[2]

Again,

"It is not a chance fact that St. Louis has developed the largest mercantile hardware house in the world. The city stands near the southwestern apex of the industrial peninsula, and the farming, mining, and grazing interests of the wide surrounding territory demand hardware more than any one class of commodities. . . . This same distributing function characterizes also in a less degree the ten cities with a population of over twenty-five thousand along the Mississippi, the seven on the Missouri, and seven on the Ohio."[3]

With the development of railroads, cities with these natural commercial locations are usually chosen as railroad termini. They then become railroad centers and their commercial prominence is thereby enhanced. For the competition between railways, and often between railways and waterways, gives to such cities an added advantage. This is because competitive necessity once made lower rates to and from them than it made for less favored communities. In consequence, a position naturally strategic has been strengthened with the development of railroads. For with the added advantage of the lower railway rates there is greater reason than ever to use these places as market centers from which to supply outlying territory. Milling and storing in transit privileges, together with special carload rates, commodity rates, basing point rates, and other privileges of railway rate structure, together with the competitive advantage of generally low rates, assure to such cities a continuance of their position as important commercial centers.

[2] Helen Churchill Semple, *American History and Its Geographic Conditions* (1903), p. 361.

[3] *Ibid.*, p. 344.

The widening of the markets available to producers and distributors is always of interest to transportation agencies, for the carrier's volume of business is thereby increased. Railroads in a given territory, for example, usually make rates in such a way as to enable their producers and distributors to sell in as many markets as possible. The problem of procuring markets for a particular business may become to a degree, therefore, the problem of the railroads on whose lines it is located.

Transportation facilities provide for more than the creation of place utilities. They provide an important service in storing. For a transportation service must in reality serve the double purpose of moving and storing goods.[4] The fact that the goods are in the possession of transportation facilities for some time has an important bearing upon finance and risk. Funds must be invested in goods while they are en route and the volume of stocks held in storage is in part dependent upon the speed and the dependability of the transportation service. The bill of lading has been made an important type of collateral security,[5] and has thereby become an important adjunct to financing goods in transit.[6] The extent to which the carrier acts as bailee for the property entrusted to it, and the resulting degree to which it becomes responsible for the safe and prompt delivery of the goods entrusted to it, raises important questions which concern the distribution of risk.[7]

Factors Determining Efficiency.—The efficiency of transportation is measured by two factors, the service performed and the cost of performing the service. The adequacy of the

[4] The less of such storage there is at either end of a journey the more fully the transportation system can be utilized. And it is with this in view that demurrage charges and track storage charges have been introduced. See pp. 310–312.

[5] See the Bill of Lading Act (Pomerene Act), of 1916; also the *Annual Report* of the Interstate Commerce Commission (1919), p. 32, and U. S. v. Ferger, 250 U. S., 199.

[6] See pp. 340–341, 345–346.

[7] See Chap. XVII.

service rests upon such basic considerations as (1) the supply of facilities to carry the products offered,[8] (2) the speed and care with which goods are carried from point to point, and (3) the speed and care with which products are handled at terminals. These three fundamentals are, of course, interrelated. Thus, in the case of railroads, if the speed of trains is increased, a given number of cars, and hence the total car supply can carry a greater tonnage in a given time. Again, a large part of the life of the average freight car and freight vessel is spent at the terminals where they are loaded and unloaded, and it has been estimated that two-thirds of railroad expense is paid for terminal service.[9] Congestion in a single yard may tie up a whole railway system; and congestion at a single terminal city or port may tie up the transportation system of a large area.[10] Consequently, if facilities for loading and unloading at terminals are improved, the time that cars are en route instead of serving as warehouses at terminals, is increased. To increase the speed of movement or to reduce the time spent in terminals shortens the time of transportation and increases the available car supply. The power of locomotives, the size of cars, and the number of each are, of course, fundamental.

The Relation of Transportation to Market Areas.—The extent of the market for any commodity and the territory which sends its produce to and which is supplied from any distribution point are limited by the adequacy of the transportation facilities and the cost of their utilization. Without adequate transportation large scale production and localized industry are commercially impossible. These developments have come only with the widening of the market area within

[8] This becomes particularly important in such times as the rush season for carrying grain during the fall of the year.

[9] E. J. Clapp, "Railroads and Terminal Waste," *The New Republic*, Feb. 1, 1922, p. 268.

[10] The congested condition at the New York terminals during the winter of 1917–18 was given as one main reason for the "heatless Monday" order of the Fuel Administration.

which products can be profitably distributed. During the past century, facilities for transport have been so improved and the costs of transportation have been so reduced that there is a "world market" for hundreds of products. This development has continued during the past few years. The speed of transport has been increased on the public highway through the improvement of the roadway and the utilization of the motor truck, loading and unloading devices have also been improved. The speed of railway trains has been increased, the capacity of individual cars has become greater, and the pulling power of engines has been increased. A similar development has occurred in waterway transportation. But here the facilities at terminals vary greatly as between different ports. In some cases human labor is utilized almost entirely; in others it is almost entirely dispensed with. Warehouse facilities, likewise, vary. The extent of this variation depends in part on the nature of the product which is being handled, and in part on the cost of labor and the importance of the port.

Carload Rates.—Since it costs less to handle, load, and unload car loads than it costs for similar services for equal amounts shipped in less than carload lots, the rates charged for shipment in carload lots are commonly lower than the rates for similar products shipped in smaller quantities.[11] In addition to this, deliveries of carload freight are usually made more quickly than those of less-than-carload freight. These facts make it advantageous to ship in large lots and give a decided advantage to those who can do so.[12] The difference

[11] Governing decisions of the Interstate Commerce Commission are: Thurber v. N. Y. C. & H. R., 3 I. C. C. 473; Harvard Co. v. Pennsylvania Co., 4 I. C. C. 212, 213.

[12] The wholesale grocers have complained that the large meat packers gain an advantage of this kind because they are allowed to ship grocery products in meat cars, which receive preferred treatment by the railroads because they carry perishable meat, whereas the wholesale grocers have to ship by ordinary freight. They further complained that the packers shipped groceries in their "route cars," which are carried from

between less-than-carload and carload rates is particularly important when transportation charges make up a large part of the final cost of the product. This is usual with bulky articles of relatively low value, such as grains, live stock, ores, and crude steel products. The expense of shipping in very small lots is usually relatively great.[13] The minimum freight rate, for example, is based on one hundred pound units. It is these conditions which make necessary the concentration of farm products at country shipping points, and which usually make it cheaper for a retailer to buy from a jobber or the near-by branch of a manufacturer, than to buy direct from a distant producer, and for the final consumer to buy from the retailer rather than of the producer.

Carload Rates and Jobbing.—It was pointed out earlier in the chapter that the development of railroads has tended to continue old market cities. But it has done more than to continue the old distributing centers, for it has also led to the development of new ones. The differences that exist between carload and less-than-carload rates make it desirable to transport goods in carload lots as near to the final purchaser as is possible. There have developed, consequently, numerous small distributing points to which goods are brought in carload lots, to be used at the point of receipt and to be dispersed in less-than-carload lots throughout the tributary territory. Just as soon as a city and its vicinity can use goods in carload lots it is on the way to become a jobbing center.[14]

town to town to make deliveries of meat, and from which groceries were also delivered. By the "consent decree" of 1920 the packers agreed not to handle certain large classes of grocery products.

[13] Smaller packages, and articles demanding very rapid transportation are usually carried by express or parcel post. The rates for this service are relatively high. But in addition to the more rapid and certain service, delivery service is also provided. See E. R. Johnson and T. W. Van Metre, *Principles of Railroad Transportation* (1916), Chaps. XIII and XIV.

[14] See, for example, the discussion of Amarillo and Sweetwater, Texas, in the Texas Common Point Case, 26 I. C. C. 528.

This tendency becomes greater when prices are much affected by transportation costs, or when speed in delivery is desirable. With most staple commodities both of these are important; and the latter is a particularly important consideration in the marketing of perishables.

Groceries are consumed in such large amounts and the cost and speed of transport are so important that there are hundreds of jobbing centers for groceries in the United States. The same conditions exist in a smaller degree in the distribution of drugs, farm machinery, dry goods, and hardware.[15] In the sale of jewelry, women's expensive clothing, and musical instruments they are less important and there is a much smaller number of jobbing points. It was shown in Chapter VIII that the growing emphasis on a rapid retail turnover has strengthened the local jobber as against large jobbing houses located in the larger commercial centers. This is due to a considerable extent to the fact that he can make a greater use of carload shipments than can the larger houses, and he makes a minimum use of less-than-carload shipments. This practice reduces costs of transportation and enables him to make more rapid deliveries, because carload shipments are delivered more quickly than less-than-carload. And since local jobbers are near to their customers they can deliver by truck or at least their small shipments can be made more quickly than could similar shipments from distant manufacturers and

[15] C. C. Parlin found something over 1200 jobbing centers in the grocery trade in 1915 (*An Address delivered before the district sales managers of the Joseph Campbell Co.*, p. 7, published by the Curtis Publishing Company, 1916); the five large meat packers alone had 1120 branch houses in operation in 1917 (*Report of the Federal Trade Commission on the Meat-Packing Industry, Summary and Part I*, p. 153); there were twenty distributing centers for farm machinery in 1918, each of which had five or more jobbing houses or manufacturer's branches, and there were 27 farm implement manufacturers who had in the United States, alone, in 1918, 282 branch houses, and sold through 140 jobbers. And, in addition to these, they used 444 stock transfer houses. (*Report of the Federal Trade Commission on the Causes of High Prices of Farm Implements* [1920], pp. 52–54.)

jobbers. When freight rates are increased their position is made yet stronger, for their transportation advantages are thereby increased. To offset these disadvantages the large distributors have established branch houses,[16] and railroads leading from the larger market centers have introduced package cars to increase the speed of freight. The general extension of the mixed carload privilege has served to cut costs of transportation.[17] Large jobbers endeavor to have the differential between carload and less-than-carload shipments cut down so that they can compete more successfully in a wider territory.[18]

Some Special Features of Transportation Service.—There are many special features of freight service which have particular effects on the market structure. The transportation service of the express companies and the Government's parcel post are built around the railway system of the country. The express service is used particularly in carrying merchandise which is of slight weight and high value—valuable merchandise, printed matter, or money, jewelry, precious metals, and valuable documents, which the railroads will not take. Express is shipped on passenger trains and on special express trains. It serves particularly in the transportation of commodities which require more rapid transportation and delivery than is given by the regular freight service. In addition to more rapid transportation the service includes the collection of merchandise from the shipper and its delivery to the consignee. The cost of this service to the shipper is in the neighborhood of four times the ordinary freight rates for the same

[16] In discussing the reason for their establishing branch houses Mr. E. C. Simmons of the Simmons Hardware Company, of St. Louis, said in 1906: "It is a well recognized fact that in many cases promptness is a more important and determining factor in getting business than even price, but put the two together and they are irresistible."—"A Half Century of Hardware," *Iron Age*, Vol. 77 (Jan. 4, 1906), pp. 145–148.

[17] Business Men's League of St. Louis case, in 9 I. C. C. 318.

[18] Consolidated Classification Case, 54 I. C. C. 1, 16–19.

shipments, and so only goods of relatively high value can be shipped by express.

Since 1912 the Post Office Department has been developing a parcel post service which duplicates much of the service performed by the express companies. But it is not so complete nor so satisfactory for many shippers as is the express service. Goods are only delivered, they are not collected from the shipper. Losses are not met so fully by the government, and rates for distant traffic are higher. But for short traffic the parcel post rates are cheaper, although the collection service which express companies render at many points may offset this advantage. The great development of rural deliveries of mail is also a decided advantage in shipping to country districts, for the express service maintains no rural delivery. Uninsured packages may be shipped very cheaply by parcel post and the losses insured in outside companies, or the shipper may be willing to assume any losses, or the package may be insured through the post office.[19]

Refrigerator cars and cold storage warehouses make it possible to bring the perishable products of distant lands, fruits, vegetables, meats, and fish, to our table, and enable us in turn to send perishables to distant markets.[20] California, Florida, Washington, Michigan, and Central American fruit, dressed meats, and early southern vegetables could not reach what

[19] For a more complete description and comparison of these services see Johnson and Van Metre, *op. cit.*, Chaps. XIII and XIV.

[20] It is assumed that the reader is familiar with these factors. For fuller discussions see L. D. H. Weld, *Private Freight Cars and American Railways*, Columbia University, Studies in History, Economics, and Public Law, Vol. XXXI, 1908; *Report of the Federal Trade Commission on Private Car Lines* (1919), and on the *Wholesale Marketing of Food* (1920); E. G. Nourse, *The Chicago Produce Market* (1917); also the more general discussions in Johnson and Van Metre, *Principles of Railroad Transportation* (1916); and L. G. McPherson, *Railroad Freight Rates in Relation to the Industry and Commerce of the United States* (1909). See also various bulletins of the U. S. Department of Agriculture.

are now their normal markets but for refrigeration. A further use for refrigerator cars is found in winter when goods are carried which would freeze in ordinary box cars. Heater cars have also been developed, and special equipment has been introduced for carrying other products, such as live stock and petroleum. Special stock trains are run from growing sections to central markets. There are also fast freight lines for perishable foods, the purpose of which is to have the refrigerator cars used on a railroad's lines joined in special trains to run at top speed to central markets.[21]

These special facilities, which were developed much later than the railways, were first introduced by interested shippers. This was the case because special cars, especially the refrigerator cars, were expensive and required inspection and attention from point to point—expenses and services which the railways were not willing to provide. Furthermore, refrigerator cars are used during only a part of the year and must go from line to line to be utilized profitably. The fear that they would not prove profitable because of this limited seasonal use, and the inability of individual railroads to control their cars when on other lines, as well as a frequent disinclination to allow cars to leave their lines, have all proved to be important causes for outside ownership. The railroads now own many of these private cars, and so to-day private car lines are relatively unimportant save in a few industries.[22]

[21] See In the Matter of Private Cars, 50 I. C. C. 652. In addition to special cars and boats, pipe lines have been developed for the transportation of petroleum, and there are elevators, belt conveyors, motor trucks, and other special means of transport.

[22] Private cars compose now about 6 per cent of the total owned by the railroads. The ownership of this specialized equipment by large shippers was formerly a source of much complaint by competing shippers. The railways paid a rental for the cars which was claimed to be so large as to amount to a rebate, and competing shippers did not get good service. These cars are now under the control of the Interstate Commerce Commission, and the problems suggested are largely solved. See, however, the recent complaint of the wholesale grocers made before the Commission of the uses made of route cars by the meat packers in

Diversion in Transit.—The diversion of cars in transit is a privilege of great importance to shippers. This enables a shipper to send his car in the general direction in which he wishes it to go, without his deciding upon a specific market at once. When the car reaches a diversion point established by the railroad, it may be sent to the specific market which the shipper then believes gives the greatest promise. This service is particularly important in the case of perishables and of products long on the way to market. In either case the demand in different markets may change while the goods are en route, and to reach the best market they must be diverted from their original course. In the case of perishables this is peculiarly important, because they cannot be stored to await a more favorable price. They must be sold at once or shipped without delay to another market where better prices can be obtained. Market news is usually so incomplete that it is often impossible to tell at the time of shipment whether a particular city will offer a good market by the time a carload has reached it. Furthermore, products sometimes deteriorate more rapidly than is anticipated and so the more distant markets cannot be reached in time. But when the product has reached a diversion point the shipper or his representative can determine its condition and so he is better able to judge what city offers the best market.[23] The diversion privilege allows the product to be sent on from point of origin to the final market at the through rate plus a small diversion fee.[24]

Somewhat similar services are the privileges of milling and storage in transit which are accorded wheat shippers, and the

carrying products which compete directly with the wholesale grocers. The grocers' side of the case is presented in *The Case Against the Packers as seen by the Wholesale Grocers of the South* (1919), prepared by Lewis H. Haney for the Southern Wholesale Grocers' Association, Jacksonville, Fla.

[23] The diversion of "tramp" ocean steamers is likewise a common practice.

[24] See the Reconsignment Case, 47 I. C. C. 590; 53 I. C. C. 455.

provisions for compressing cotton while en route to the market, and for the storing and grading of wool on the way to the East from western growing regions. In the first case, wheat may be sent to the milling point, stopped for milling, and then shipped on to the market, all at the through freight rate, plus a transit charge. This saves paying the relatively higher local freight rates to the point of milling and from the point of milling to the market. Shippers are also allowed in some instances to ship grain and live stock to a terminal market and then to send it on in the same general direction at a rate less than the regular local rate from the terminal to the final market place. This tends to equalize the position of millers and meat packers located at different points.[25] Similar to this is the privilege of compressing cotton bales in transit. This service is necessary in order that the large bales shipped by the grower may be reduced to a more suitable size. Usually the local shipper pays the full local rate to the compression point, but on proof of reshipment he is allowed a refund of the difference between the local rate and the lower through rate.[26]

Cities which are able to procure privileges such as those which have been mentioned for products passing through their section of the country, are enabled thereby to divert a large proportion of the traffic which might perhaps pass through other points.[27] This tends to the development at such points

[25] See J. Chester Bowen, *Wheat and Flour Prices from Farmer to Consumer*, U. S. Bureau of Labor Statistics, Bul. 130 (1913), pp. 26–27, and the following Interstate Commerce Commission Cases: Substitution of Tonnage, 24 I. C. C. 340; Transit Case, 25 I. C. C. 130, 26 I. C. C. 204; and compare Fabrication in Transit, 29 I. C. C. 76.

[26] See Louisiana Cotton, 46 I. C. C. 451; Business Men of Helena v. St. L., I. M. & S. Ry. Co., 48 I. C. C. 490.

[27] St. Louis has recently been made such a diversion point for lumber. Lumber from the South is shipped to St. Louis, sold by the selling agents there and shipped on at the through rate from point of origin to the final market, plus a nominal shipping charge of two and one-half cents per 100 pounds. Before this privilege was granted the local rates

of markets, jobbing centers, storage facilities, a milling industry, or of whatever a particular rate privilege tends to foster.[28]

Transportation Costs.—Since the transportation charge is a distinct part of the final cost of an article delivered to the consumer, it is evident that the cost of transportation limits the extent of a market available to a given producer, manufacturer, or distributor. Other things being equal, the seller who has the lowest transportation costs on the materials, equipment, and supplies which he uses and on the shipment of his product to market can sell at the lowest price, makes the greatest net profit, and, if his supply is great enough, may even control the market. Most of the products now consumed would, furthermore, not be available to the majority of the population of the world if it were not for the low costs of transportation which now prevail. Improved methods have brought lowered costs as well as superior service.

Even to-day the cost of carriage is an important element. California oranges could not compete in eastern markets with those of Florida were it not for the relatively low freight rates charged on their shipments; neither could Washington apples compete in eastern markets with those of Michigan nor the latter with those of New York.[29] Factories are usually placed with a view to the cost of transportation, both for bring-

to and from St. Louis had to be paid. It is estimated that this will save $300,000 a year to St. Louis lumber interests. See the statement of W. P. Coyle, traffic commissioner of the St. Louis Chamber of Commerce, quoted in the *Chicago Journal of Commerce*, July 20, 1921.

[28] An idea of the great number and variety of these special privileges can be obtained by glancing over the index to the volumes containing the decisions of the Interstate Commerce Commission. A wealth of marketing information is contained in the discussions of the cases which come before the Commission.

[29] With the increase in freight rates since the World War and the fall in the price of farm products, the transportation rate has become peculiarly burdensome to the farmer. This is on account of the fact that the price he receives is the price at the central market less the shipper's margin and the cost of transportation from the local market.

ing raw materials and other supplies to the factory and for carrying the finished product to its market. Some cities have outdistanced rivals, with otherwise equal natural advantages as manufacturing and distributing centers, because of the lower freight rates they have enjoyed to consuming and raw material markets. Great productive areas of the globe are as yet unopened to world commerce, not merely because their transportation services are meagre, but because the cost of those services is prohibitive.[30]

The railway rate on particular articles often has little effect on the retail price of goods.[31] A difference of several cents a hundred pounds in the rate often means far less than one cent on individual items sold to the consumer.[32] On the other hand, such differences are very important in the wholesale trade, and in the trade in bulky articles. They may be sufficient to cause a factory to procure raw materials from one

Thus if the wholesale price which affects his local market is one dollar and the freight rate five cents, the grower's price is ninety-five cents less the shipper's spread. If the freight rate becomes ten cents, the grower's price becomes but ninety cents, less the shipper's spread. See pp. 440–443.

[30] Many of the peculiarities of American rate structure have arisen from the desire of railways to obtain and keep trade for the particular territories they serve. Note the early rate struggle between the roads serving Boston, New York, Philadelphia, and Baltimore. See W. Z. Ripley, *Railroads: Rates and Regulation* (1912), pp. 21–23, and Chaps. IV-VIII, X-XI; Logan G. McPherson, *op. cit.*, Chap. VII; E. R. Johnson and G. G. Huebner, *Railroad Traffic and Rates,* Chaps. XVII, XIX.

[31] The freight rate on most consumption goods is so low in relation to their value that a large increase in rates will have little effect on prices. But this is not true of production goods. Thus of the price of coal in Chicago in 1914 the railway freight charge was nearly two-fifths of the retail price of anthracite, nearly one-half for smokeless mine run, and nearly one-quarter for Southern Illinois bituminous. With the higher rates and higher prices prevailing in 1921 these amounts were: for anthracite, approximately the same, for smokeless mine run, two-fifths, and for Southern Illinois bituminous, approximately the same as before.

[32] F. Andrews, "Methods and Costs of Marketing," U. S. Department of Agriculture, *Yearbook,* 1909, pp. 161–162.

territory, rather than from another, or a retailer to buy of the jobbers of a city from which goods can be shipped at a lower cost. Slight changes in rates have frequently caused grave dislocations of commercial relations established under a former rate.

Certain kinds of transportation are cheaper than others. Rates are usually lower on waterways than on railways. For some products the transportation rate from San Francisco to New York is greater than from Hong Kong to New York.[33] The low rates charged on waterways with which railways compete sometimes force the railroads to adopt rates between points connected by waterways which are much lower than the rates for the same service between points not so favored.[34]

Local Trucking.— Railroad and steamship lines are not the only factors in the determination of transportation costs. Of particular importance is trucking. At each end of a shipment over railway or

[33] For a discussion of this and many other cases in American railway history, see L. G. McPherson, *op. cit.*

[34] Since ocean freight rates are subject to constant change, facts of this kind change likewise—although the general relationship is not likely to be materially altered.

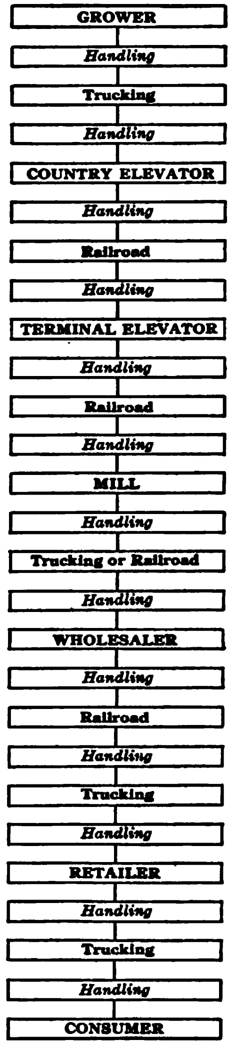


Diagram VI.—The Physical Handling of Wheat, from Grower to Consumer.

waterway there is usually an element of local trucking or carrying that may be as costly as the through carriage or even more costly than it is. The farmer draws his grain to the country elevator whence it goes over the railroad to the milling center where it may be unloaded directly at the mill warehouse or may have to be transported again by truck. It is loaded, as flour, from the mill to ship or car, and then at the end of its journey is transferred by truck or wagon to the jobber's warehouse, from which it must be carried to the retail store, and from there to the home of the final consumer. It was estimated in 1912 that the cost of carrying grains from farm to car was as great as the cost of railway transportation.[35] If this is true it is evident that the total of all trucking and carrying costs, other than railroad, is very much in excess of the costs of the railroad service. In 1917 household goods could be carried from New York to Wilmington, Delaware, by motor truck for less than by railway freight, and the cost of hauling the goods to and from the railroad and the cost of packing them for freight shipment were avoided when the goods were shipped by motor truck. The importance of the physical handling of products, including trucking, is shown in Diagram VI and Table VII.

In view of the enormous amount of hauling on the common roads and streets it is obvious that anything that eliminates the necessity for it, or reduces the time and expense it involves, will have a very important effect upon the cost of transportation, and hence upon the cost of marketing. Some of the means for bringing this about are the location of factories on railroad or waterway, the location of central produce markets near terminals, the reduction of deliveries to consumers, and the improvement of highway transportation.[36]

[35] See L. D. H. Weld, *The Marketing of Farm Products* (1915), Chaps. IX–XI.

[36] Chicago has an underground railroad with 60 miles of tracks which connect the freight depots with some of the large warehouses of the "loop" district.

TABLE VII. CARTAGE COSTS IN WASHINGTON, D. C.*

Business	*Percentage of Delivery Costs to Gross Sales*
Ice	45.6
Soft drinks	20.2
Brick	19.9
Bakeries	19.8
Laundries	15.3
Coal and wood	15.2
Ice cream	14.9
Dairy products	12.1
Breweries	9.2
Lumber	6.8
Groceries and meat	4.4
Hardware	3.0
Furniture and carpets	2.8
Department stores, hatters, furriers, and shoes	1.5
Wholesale meats	1.1

* E. F. Hartley, *Study of Cartage Costs in the City of Washington* (1917), pub. by the U. S. Census Bureau. See also Chicago Tribune, *Motor Trucks in the Chicago Territory* (1918), p. 26.

The World War stimulated and improved trucking in the United States. Motor trucks now transport appreciable quantities of goods from city to city. They also increase the area from which goods can be conveniently hauled to and from a railway or waterway, as well as the natural hauling area surrounding a particular market. A much larger producing and consuming area can, consequently, be brought into touch with the main arteries of traffic. Increased speed in delivery likewise results. In the opening of larger farm areas alone it is evident that, through increasing the cultivable areas that can be profitably utilized, this may bring a large increase of products available to the market. Improved highway transportation is also causing the disappearance of the country crossroads store.

II. Handling Products at Terminals

Another important feature of physical distribution is the handling of products at shipping and terminal points.

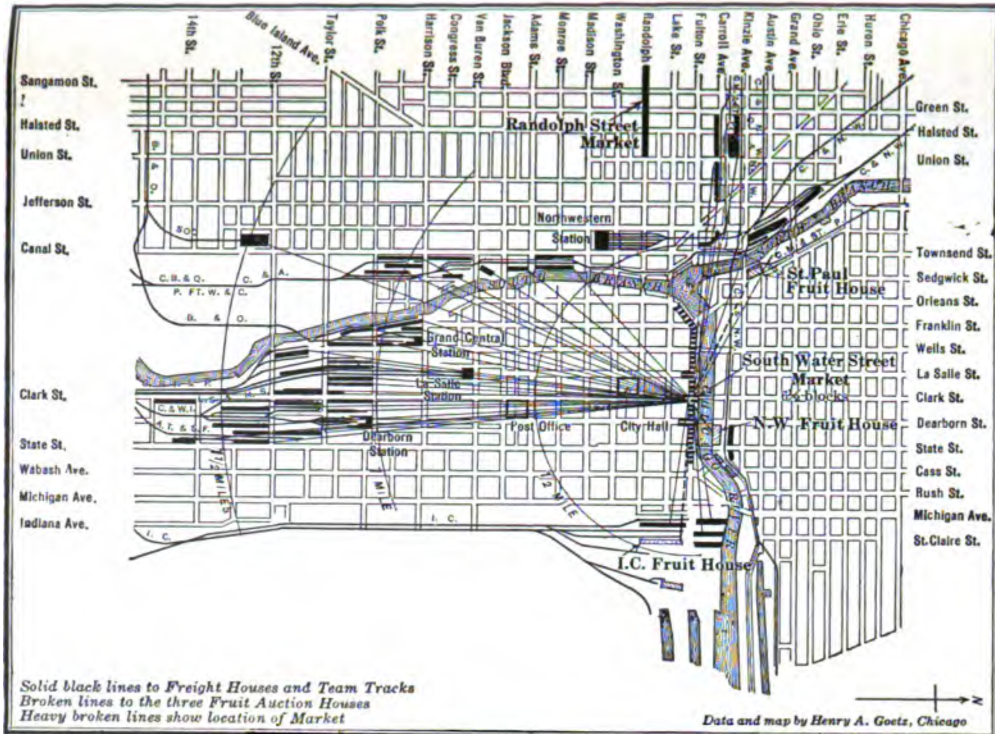
Among the marvels of our machine age are the facilities that have been developed for loading and unloading commodities at transportation points. Derricks, cranes, gravity chutes, cars with movable bottoms, traveling belts with buckets attached, steam shovels, and similar appliances have all contributed to increasing the speed with which goods can be loaded and unloaded. But despite these improvements the chief cause of congested conditions in transportation is usually found at shipping and terminal points.

A large amount of time is spent in loading and unloading cars, vessels, and trucks. It involves great expense for labor, and results in the deterioration of many products. Railroad yards in particular are liable to congestion.[37] The switching of cars from train to train, from train to warehouse, track, or unloading platform, and the reverse process of making up trains, is a slow and expensive process, adding greatly to the time goods must be en route and reducing the effectiveness of cars for purely transportation purposes.[38]

Aside from the mere physical difficulties involved in unloading, the traveling life of a car and the use which can be made of railway tracks are further reduced because, in many instances, those receiving goods in carloads store them in the car until they can be sold or conveniently unloaded. To offset this tendency railroads have instituted what are known as demurrage charges. These are per diem charges levied after the "free time," ordinarily forty-eight hours, for loading or unloading has expired. In the case of some commodities with

[37] Discussion of the relation of terminal cost to total transportation expense, for less-than-carload freight is contained in the C. F. A. Class Scale Case, 45 I. C. C. 254, in the Southwestern Class, 48 I. C. C. 379, 387, and in the New England Case, 49 I. C. C. 421, 455.

[38] An interesting discussion of terminal problems at transshipment points, between rail and water transportation, will be found in an article by C. O. Ruggles, "Railway Service and Regulation in Port Terminals," *The American Economic Review*, Vol. XI, No. 3 (Sept., 1921), pp. 438–446. See also E. J. Clapp, "An American Transportation System," *The New Republic*, Feb. 1, 1922, pp. 267–270.



MAP II. South Water Street Market, Chicago.[1]

[1] Taken with permission from the *Report of the Federal Trade Commission on the Wholesale Marketing of Food.*

which this difficulty is greatest, and where track and yard space are limited, what is known as track storage is levied in addition to the usual demurrage charges. Both of these charges vary from time to time, and from state to state. A common demurrage charge has been one dollar a day. In some states demurrage charges have been set by statute, and in a few "reciprocal demurrage" charges are assessed the railroads for failure to supply equipment within a stipulated time.

Congestion in Terminal Markets.—Although the purely mechanical devices used in transportation have been rapidly improved, the adequacy of transport systems is unduly hampered by the unfortunate congestion in the districts which surround many terminals and in the terminals themselves. An extreme example of this is found in the wholesale produce markets of most large cities. These are almost universally poorly situated with regard to the railway terminals from which they secure incoming products. They are, moreover, frequently badly located as regards the retail stores and factories to which the goods are to be delivered.[39] This usually necessitates an excessive amount of trucking from scattered railway terminals through crowded business streets to the wholesale market, and then further trucking from the wholesale district to outlying factories and retail stores, and even back to the terminals for reshipment. The cost of this lies not only in the trucking expenses but in the deterioration of products

[39] "There are approximately 25 freight terminals in the city [Chicago]. A considerable number of these are grouped together a mile or so from the produce district. The terminals, however, are distinct from each other, and a dealer receiving shipments over a number of different railroads must send for them to as many different terminals. For about five months of the year fruits and vegetables are received by water from Michigan and Wisconsin and must be hauled by teams from the docks to the markets."—*Report of the Federal Trade Commission on the Wholesale Marketing of Food*, p. 64. The same general conditions prevail in many other large cities, and are described in this report.

which results from their being jostled about in this way for considerable periods of time.

The causes of this congestion are partly fundamental. The concentration of wholesaling makes purchase and sale easy, but the concentration of the goods which accompanies it leads to physical congestion. The planlessness of our cities is a further cause. Many produce markets were originally established so as to be convenient to water transportation. At the present time, however, relatively little produce comes in by water, and the railway terminals are at a distance from the market places. But the markets continue at the original points.[40] American cities, furthermore, have grown so rapidly that few have been able to foresee the future, and consequently no adequate provision has been made to care for the proper relationship of transportation facilities to wholesale markets, industrial centers, and retail districts.

III. Storage

The second function of physical supply is storage. The farmer and other prime producers store the products which they harvest, or extract from nature, until they are started on the way toward mill, refinery, factory, and final consumer. Farm products and raw materials are stored at local shipping points until enough are accumulated, or until the prevailing price is sufficiently attractive to warrant shipment. They are stored at central, secondary, and retail markets until further sale and shipment take place, and they are stored at mills and factories before and during processing. Manufactured products, in turn, are stored at the factory until they are sold and shipped to market. And between the factory and the con-

[40] For a detailed discussion of these problems see E. G. Nourse, *The Chicago Produce Market*, and the *Report of the Federal Trade Commission on the Wholesale Marketing of Food.*

sumer they are stored in the warehouses of the manufacturer's branch, the public warehouseman, the wholesaler, and the retailer.

Causes for Storage.—Storage is necessary to the extent that the production and use of goods and their supply and demand in the market are not equalized. Its function is to hold goods from the time they are produced until the time they are used, in order to bring about an adjustment between production and use. It has likewise an auxiliary use in assisting the transfer of commodities from place to place. For goods are in storage while they are being shipped, and because of the economies in large scale transportation, and because shipments are sometimes delayed, storage is essential to the adjustment of supply between places of surplus production and surplus consumption. The important conditions which make storage necessary to marketing are, then, the conditions which make necessary an adjustment between times and places of surplus production and times and places of surplus consumption. They are as follows:

1. Goods produced during a short season of the year must be held over if they are to be consumed in other seasons.
2. Goods which are consumed in large volume during short seasons are often produced more economically if the season of production can be lengthened. The resulting surplus must be held over.
3. The sale of abnormally large stocks at one time often depresses the market price. If the goods can be stored the price can be steadied, and losses to holders thereby avoided or reduced through the realization of a higher price in a later market.
4. A surplus in one market can sometimes be stored until transportation facilities can be secured to take it to a more promising market.
5. Factories and dealers must store surplus supplies and

merchandise. There are several causes for this: to take advantage of quantity prices in purchasing and of quantity rates for transportation, to guard against delayed shipments, to have enough goods on hand to meet variations in demand from day to day and from week to week.

Two Kinds of Storage.—The conditions which make it necessary to hold goods are of two general types; and, consequently, there are two kinds of storage service. First should be placed the class of storage which holds goods over a short period of time, determined by temporary market conditions and by the short time problems of relating supply to demand. If there is a temporary glut in the market for perishable goods, they may be held over for a few days awaiting a higher price. Merchants buy goods in large quantities, and these must be held until they are sold and delivered. The manufacturer stores raw materials until they are processed and finished goods until they are shipped to market. Goods are in storage while in transit and commonly for some time before and following shipment.

The second class of storage service is that which makes it possible to adjust supply and demand for products which are produced or consumed seasonally. Eggs, butter, wheat, cotton, and wool are stored from periods of abundance to periods of scarcity. Iron ore from the Lake Superior district is accumulated near the steel mills in large quantities during the summer. None can be shipped on the lakes after the close of transportation in the fall. Coal likewise is shipped on the lakes to the Lake Superior ports to be stored for winter use. And when a manufacturer produces for stock throughout the year goods which have a short selling season, this kind of storage service is needed.

Nature of Storage Service.—Five important considerations are involved in the storage of goods:

1. They must be properly cared for.
2. They must be stored at convenient points.
3. Stocks must be financed while in storage.
4. Storage must be so controlled as to protect the interests of all parties involved.
5. Storage has an important effect on prices.

Care of Merchandise.—The proper care of goods in storage is necessary if the purposes of the service are to be realized in full degree. They must not only be kept in merchantable condition—if possible in as good condition as they were when they were put in storage—but it is often possible to improve their quality or condition in ways which make them more desirable for consumption and more available for sale. Lumber is seasoned, smoked meat and tobacco are cured, and economies may be effected by harvesting a green crop of fruit and allowing it to ripen in storage. This service involves the inspection, preservation, conditioning, and grading of products. Proper provision for the safety of the merchandise calls for protection from theft, fire, wind, water, heat, cold, vermin, animals, and from natural deterioration. Goods must be inspected on arrival and on delivery, as well as from time to time during storage, to determine their physical condition. Perishable goods in particular must be given attention. This usually involves the installation of special equipment to provide "cold" and heat, in order to maintain proper temperatures for fruits, vegetables, eggs, butter, meat, and it involves the provision of special machinery for cleaning and conditioning grain—to keep it from heating in the bin or spoiling from collecting too much moisture. Finally, goods are frequently assorted and graded while in storage so as to meet more nearly the demands of the market.[41]

[41] An interesting development in warehousing is the Bush Terminal in New York City which provides many facilities not generally provided by warehousemen, see *The Bush Magazine,* Aug. 15, 1917, and other issues. Descriptive material can also be secured from the Bush Terminal Company.

Place of Storage.—Several considerations bear on the determination of the most convenient place at which goods shall be stored. They arise out of the need to make the storage facilities serve with equal advantage the interests and requirements of the producer, middleman, manufacturer, and final consumer. Furthermore, the facilities must be located at points which will expedite the transportation of goods, and make them most available as security for the loans with which their storage and distribution is financed. Goods which have left the place of production and which are en route to the places of consumption tend, consequently, to be stored near to transportation facilities, near to the markets in which they are bought and sold, and near to the financial agencies which provide the funds invested in them. This causes surplus supplies to be stored close to the large commercial centers where the means of transport, exchange, and finance are concentrated. With improvements in the speed of transportation and reductions in its costs this tendency may be accentuated. Supplies for consumption and manufacture can be quickly secured from central markets and so the need for storing in large quantities close to the consumer has been minimized.[42] A further cause for the concentration of warehousing in central markets is the fact that the inspection and supervision of warehouses is important to their proper functioning in the care of products which are to be used as the basis for loans, and which are to be sold on the basis of samples. This is more effectively done on a large scale near to the agencies most directly involved. The economies in transportation and distribution in large amounts make it desirable to locate warehouse facilities where merchants who buy in large amounts concentrate. There is, therefore, a further need for storage facilities at those jobbing markets at which wholesalers, manufacturers' branch houses, and transfer points are located.[43]

[42] This makes possible a more rapid stock-turn. See pp. 201–205.

[43] "In order to save freight by car lot shipments and to have imple-

Finance and Storage.—It is as a consequence of the long time through which many products must be stored and the great volume in which this is done that some of the greatest problems of market finance arise. For during the whole time that goods are in storage funds are invested in them. These may be the funds of the producer, middleman, financial agency, manufacturer, or consumer. But whoever furnishes the capital must bear the risk of losing his investment through the loss of the goods by deterioration or theft, or from the consequences of a falling market. Because of the importance of this aspect of storage great attention is commonly paid to the relation between warehousing and finance. The goods stored are often the security for loans made by banks or the credit allowed by supply houses. To expedite financing, the warehouse receipt has been developed to a high degree by associative activity and by law, until it now exercises in many trades the same function in financing as is exercised by the bill of lading. In fact, it often happens that in the progress of goods to a market, both bills of lading and warehouse receipts serve alternately as collateral security for the loans which finance the exchange from the time the goods leave the producer until they are finally absorbed in manufacture or in retail trade.[44]

The risk of financial loss to those who have purchased goods and to those who have loaned the money with which these purchases were made, makes it imperative that every safeguard be provided to insure against loss while the goods are in storage. The important conditions essential to proper ware-

ments and repairs readily available to retailers or farmers, some manufacturers have transfer points which are no more than distributing stations located at various centers where no branch house is maintained."—*Report of the Federal Trade Commission on the Causes of High Prices of Farm Implements* (1920), p. 58.

[44] See Chap. XVI; also R. L. Nixon, *Cotton Warehouses*, U. S. Department of Agriculture, Office of Markets and Rural Organization, Bulletin 216 (1916), pp. 2–5, and Wm. B. Thompson, "The Warehousing of Cotton," *The Manufacturers' Record, Supplement*, Oct. 23, 1919, p. 63c.

housing, from the financial side, are best discussed from the point of view of the banker, or loaner of funds. These are usually of equal importance to the owner of the goods, but since he may have them stored in his own warehouse the points are not all of equal importance to him.[45] (1) The goods must be stored under proper conditions in warehouses controlled by firms which are reliable and responsible for the proper performance of the storage functions. Since the return for the money invested in them is contingent on the merchantable condition of the goods, care for their proper storage is of the greatest importance. This involves proper facilities for the physical care of the goods, and provision for insurance against fire and theft. (2) Although salable goods are, in the last analysis, the security for the funds invested, they are of little value as security unless ~~the title to them~~ is clearly ~~in the hands of the~~ interested party. This is usually given by a warehouse receipt representing the goods stored. And the safety of the invested funds is not properly safeguarded unless this receipt gives a clear title to the goods to the holder of the receipt. It was in large part to make this title secure that the United States Warehouse Act was passed in 1916,[46] and it is with this in view that uniform state laws are urged so that banks can be certain of the status of the security for the loans they make.[47] (3) It is necessary that the value of the goods on which loans are made shall be accurately determined. As a result the quality and grade of the goods involved must be known in order that their exact

[45] See *Manufacturers' Record, Supplement,* Oct. 23, 1919, pp. 65 ff.

[46] See U. S. Department of Agriculture, Bureau of Markets, Service and Regulatory Announcements, No. 61 (June 2, 1920), *Information Concerning the United States Warehouse Act.* This is equally important in transportation, and is responsible for the passage of the Uniform Bill of Lading Act, see C. S. Duncan, "The Uniform Bill of Lading," *Journal of Political Economy,* Vol. XXV (1917), pp. 679–703.

[47] Mechanics' lien laws, for example, sometimes give prior claim to the laborers who produce goods, and may prevent banks from obtaining title to the goods.

market value can be ascertained. If in addition to this, the goods have been sold for future delivery, or their future value has been assured through hedging, their value as security for a loan is thereby enhanced. Here again the necessity for proper storage is important, so that the quality of the goods may be maintained until the loan is paid off.

Control of Storage Facilities.—Storage is carried on both as an adjunct to private business and as a public service business. Factories, wholesale middlemen, and retailers usually have their own storage plants in which to warehouse the materials they use or sell. But agricultural products on reaching the market, whether they be used for consumption or as raw materials for manufacture, are often stored in public warehouses.[48] In central markets, especially, many warehouses are owned and operated by private companies for the express purpose of providing storage service. Grain, cotton, and tobacco when not placed in the private warehouses of buying merchants are stored thus,[49] and much cold storage business is done in public plants. Manufactured products, likewise, are frequently stored in public warehouses located in wholesale centers.[50]

[48] There are 248 cotton warehouses licensed under the United States Warehouse Act listed in *Service and Regulatory Announcements*, No. 68 of the United States Bureau of Markets, May, 1921. This number had been doubled by September 1. Rapid progress is also being made with the licensing of grain and wool warehouses.

[49] The grain storage capacity of the United States has been estimated as follows:

	Number	*Capacity in Bushels*
Terminal warehouses	351	262,000,000
Country warehouses	20,589	521,000,000
Mills	7,213	150,000,000

From *Address of Julius H. Barnes to the Committee of Seventeen*, Nov. 5, 1920, p. 16.

[50] This is illustrated by the practice of some agricultural machinery manufacturers who store machinery and equipment at wholesale centers in which they have no branch house. See *Report of the Federal Trade*

The control of warehouses, more especially of public warehouses, is an important element in the successful storage of products. It is especially important to the financing of marketing, since a large part of the stocks of raw materials and foods and an appreciable part of the supplies of manufactured goods are stored by independent warehouse concerns. The owners of goods are often unable to supply their own storage space and, furthermore, the service is often better rendered and more cheaply supplied when carried on on a large scale by independent, specialized agencies. From the point of view of the owner of goods, the chief service of the public warehouse is to provide a place in which the goods can be safely stored and properly safeguarded, and to furnish to the owner a negotiable receipt indicating the kind and grade of product stored, the amount stored, and the ownership.[51] Its function is to store surplus supplies of seasonal goods, to hold goods when the market is unsatisfactory, and to carry supplies for manufacturers and merchants. Warehousemen sometimes, too, serve as financial middlemen as well as storage agents, either through advancing funds directly, or assisting the owner in borrowing from financial houses.[52]

The rates which are charged and the service which is rendered by public warehouses are often regulated by the state much as are public utility rates and service. This is done

Commission on the Causes of High Prices of Farm Implements, p. 58. Meat packers have "storage and delivery" houses, local merchants who store goods as shipped and deliver to customers secured by the packers' salesmen. See *Report of the Federal Trade Commission on the Meat-Packing Industry*, Vol. IV (1919), p. 37.

[51] Fungible goods, particularly grains, are commonly stored together. No effort is made to keep each owner's goods separated; when delivery is demanded the proper quantity and grade must be delivered, but not the identical goods.

[52] Cold storage warehousemen sometimes assist shippers in financing their purchases. See E. G. Nourse, *The Chicago Produce Market* (1917), pp. 90–91.

mainly to avoid discrimination between users. Goods are commonly inspected on entering the public warehouse so as to determine the responsibility of the warehouse for their condition and quality. In the grain trade the terminal elevators are often licensed and controlled by the local exchange as well as by the state or Federal Government.[53] For when grain is sold for future delivery, contracts are met by the delivery of warehouse receipts, and successful trading necessitates confidence in these receipts.

Storage and Prices.—Storage has an important effect on prices. By making it possible to hold surplus products over from periods of surplus production to be consumed uniformly throughout the year, it helps in the adjustment of supplies to the needs of consumers, and thereby exerts an influence in stabilizing prices throughout the year. When surplus supplies are kept off the market, prices are raised during periods of abundance and consumption is thereby reduced, so that the supplies are consumed more uniformly. Again, since stored goods can be used as the basis for loans, it is possible for those who produce goods which are consumed seasonally to use the produced goods as security for loans, and they are thereby enabled to produce more uniformly throughout the year. This permits manufacturers to iron out production peaks, and so it results in improved production and reduced costs.[54] Temporary gluts in the market can be avoided, as well as temporary shortages, because goods can be stored and need not be sold at once when they are

[53] See James E. Boyle, *Speculation and the Chicago Board of Trade* (1921), pp. 97–113, for a brief history of the controversy between the Board of Trade and terminal elevator companies over the control of public elevator service.

[54] Paul M. Atkins discusses the problems involved in seasonal demand and the means used in meeting them in an article "Solving the Problem of Seasonal Goods," in *Administration,* Vol. II (Oct., 1921), pp. 473–484.

produced. The net effect, then, of storage is to make prices and consumption more uniform throughout the year.[55] This, likewise, causes a larger production and consumption of seasonal goods, for consumers are given a longer time in which to consume, and out of season prices do not rise so high as they otherwise would. Producers can bring larger supplies on the market because they do not need to be "dumped" during the short season of production. Since the surplus can be held over for later sale, prices are higher during the season and losses from dumping can be avoided. Even in the case of highly perishable commodities, such as fruits and vegetables, which cannot be stored for long, the possibility of carrying them in storage for a few days or hours prevents the loss from immediate sale on a glutted market.

Cold Storage.—One of the most interesting features of warehousing is the cold storage business. Just as certain products require refrigeration in order to be transported to any great distance, so they must be held in cold storage if they are to wait long for consumption. In the former case, as in the latter, it is the time element involved, resulting in deterioration in quality, that necessitates the "cold." Some very perishable products, such as green vegetables and such fruits as oranges, peaches, and strawberries, cannot be held long in storage. With these the main use of cold storage, as of refrigeration in transit, is to keep them in condition while en route to market, and to hold them over for a day or more, or for only a few hours, until they are consumed, or when the market is too slow to move them, for a few days at most. But in the case of other products, such as butter, eggs, poultry, and meat, the storage period may be longer. Thus, eggs which are laid in abundance during the early summer are stored until the fall and early winter when the fresh supply is scarce. In this way prices are steadied and leveled throughout the

[55] See *Report of the Industrial Commission,* Vol. VI (1901), pp. 192 ff.

year,[56] and surplus production is encouraged during the season of abundant supply.[57]

[56] G. K. Holmes, *Cold Storage and Prices,* U. S. Department of Agriculture, Bureau of Statistics, Bulletin 101 (1913). For a discussion of the various aspects of cold storage, economic, technical, and legal, L. D. H. Weld, *The Marketing of Farm Products,* Chap. VIII, and E. G. Nourse, *The Chicago Produce Market,* pp. 83–91, are both valuable.

[57] Canning factories sometimes take the surplus of perishables from the market. This performs approximately the same service as do cold storage and warehousing for less perishable commodities.

CHAPTER XVI

MARKET FINANCE

I

The problems of market finance have to do with supplying funds with which to meet the expenses of performing the market functions—particularly to carry the necessary investment in stocks, whether purchased, in process, or produced, and to meet the costs of buying and selling.

Source of Funds.—The funds used in marketing are secured through the investments of the parties to the market, through long time borrowing, and through what is commonly called "current financing." The present discussion will be confined to this "current financing," that is, to financing which has as its purpose the supply of funds with which to provide for the current expenses involved in the production, purchase, and sale of merchandise, to carry stocks, to meet the expenses of buying and selling, and particularly to meet any extraordinary or "peak" loads which find their origin in market conditions. Many of these needs are met from the permanent investment in the business and from long time borrowing. But these will not be discussed.[1]

In most industries there are certain "peak" seasons, times at which current funds in very large amounts are in demand. And there are often other seasons in which little money is required to meet current market expenses. This is especially

[1] Discussions of these factors will be found in such works as H. G. Moulton, *The Financial Organization of Society* (1921), W. H. Lough, *Business Finance* (1917), and A. S. Dewing, *The Financial Policy of Corporations* (1920).

true, for example, with farm products and with such style goods as men's and women's clothing. The peak season is found, too, in the automobile and construction industries, and, indeed, in greater or less degree in all industry. Most retail merchants and the wholesalers who supply them, find that more funds are required at certain seasons, such as Christmas, spring, and fall, than at others. Furthermore, even though the volume of business may not vary greatly, changes in prices exercise an influence upon the financial needs of a business. But problems of current finance are by no means confined to these peak seasons. For most producing and merchandising houses depend upon short time credit, rather than on capital investment or long time loans, for some of the supply of working capital with which to meet their current expenses for producing, purchasing, and selling. Small retail establishments often have practically no working capital of their own, but depend upon their supply houses to grant them credit until they can pay for merchandise from the proceeds of its sale.[2] A disadvantage in this method of financing is that the business may become dependent in a large degree upon those who extend credit to it.

Many of the demands for funds are met from the proceeds of short time loans. This is often better than to meet them all with invested funds. For that policy would frequently cause a firm to have idle funds which at best, when not in use in the business, could be loaned with safety only at low rates of interest.[3] It is evident that in the case of a prosperous, growing business, with good credit, it would be unwise to meet the peak loads, and even the bulk of normal current expenses, from invested capital. A simple example will illustrate this. Suppose a retail firm has $50,000 and can borrow $200,000 at 7 per cent. Assume it makes 12 per cent on the capital em-

[2] On the calculation of requirements for working capital, see W. H. Lough, *op. cit.*, Chap. XVII.

[3] This is true because the all important point is to safeguard the principal so that it may be obtained, unimpaired, whenever it is needed.

ployed, i. e., on $250,000, it will make $30,000. Subtract $14,000 from this—the 7 per cent interest on the $200,000 loan—and there is left $16,000, or 32 per cent profit on the $50,000 invested by the firm. Here again, however, as in the case of the firm dependent on the credit granted by supply houses, a firm's equity in its business is small. And in case of difficulties it may quickly lose control to the bankers from whom it has borrowed.

Causes of Seasonal Needs.—The problems of seasonal finance are particularly interesting to students of marketing because they are due largely to market conditions. These problems arise from numerous causes. They may be roughly summarized by stating that excess funds are needed with which to meet the expenses of a business during the period which precedes the financial return from the sale of its product.[4] The more important of these expenses are: (1) to carry production, selling, and stock peaks which arise out of seasonal markets and cause large expenditures in advance of receipts from sales; (2) to meet variations in demand from other than seasonal causes, such as exceptionally high (or low) prices for products bought or sold, or changes in the physical volume of business; or (3) to carry the stock during a period of unusually slow returns for the sales efforts put forth. These slow returns may result (*a*) from a "slow season" in which the sale of the firm's goods does not begin as soon as usual; (*b*) from "hard times" which bring a general falling off in anticipated purchases, or (*c*) from uncertainty concerning prices, which makes buyers hold off. They may also arise (*d*) from defective sales efforts, (*e*) from "frozen credit" (the failure of purchasers to pay promptly), or (*f*) from extending credit to poor risks.

[4] See Morris A. Copeland, "Seasonal Problems in Financial Administration," *The Journal of Political Economy,* Vol. XXVIII (Dec., 1920), pp. 793–826. It is evident that not all problems of current finance are market problems, although it is safe to suggest that they arise largely out of market conditions.

For the going concern, the actual amount of current funds needed is determined primarily by market conditions. If the market is not seasonal, this amount will be relatively constant. For after the product begins to reach the market, there will be a steady flow of products out of the factory and a flow of income into the treasury. This will offset the steady payments for materials, supplies, labor, advertising, and other current expenses. Such a condition with income balancing outgo is, however, seldom realized, and the industries are few indeed in which there are no problems of seasonal finance. Even with these fortunate industries many problems of current finance arise. For general business conditions affect the volume of sales, a firm's sales may slacken, payments may be slowed up with a slowing up of general business, prices vary from time to time, and deliveries of raw materials are irregular. These and many other considerations make it impossible for business to depend upon current income always to meet current outgo.

Conditions Determining Current Financial Needs.—Certain fundamental elements affect the current funds normally needed in a business. Variations in these elements, likewise, largely cause the variations from the normal which arise from time to time, as they are also responsible for varying conditions in different lines of business. Among the more important of those which influence the financing of distribution, or which arise out of market conditions are:

1. The volume of business done.
2. Unit costs, including (*a*) the costs of production and of materials, supplies, and finished goods and (*b*) the unit cost of selling and buying, and of performing the other market functions.
3. The length of time the goods are in preparation for the market: manufacture, assorting by quality, quantity, etc., in storage.
4. The stock of finished goods, materials, and supplies which

must be kept on hand in excess of the immediate needs of the plant or store—to accommodate the business to fluctuations in demand for the product and in the supply of materials and supplies.

5. Variations in stocks and in volume of business which arise out of seasonal conditions in production or marketing.
6. The accuracy with which production, or purchases, and sales are correlated. This normally shows itself in practice in the correlation between purchase and payment for the goods to be merchandised and the sale and collection of payment therefor. It involves the correctness with which the market is anticipated, the skill with which the purchasing is done, the success of the sales campaign, and the effectiveness with which collections are made.
7. (*a*) The terms of payment for sales and purchases, such as the discounts for cash, and the credit terms taken and given. (*b*) Carload freight rates and discounts offered for quantity purchases.
8. Variations in the prices of the goods and services involved, an element affecting the unit costs mentioned in 2.

Discussion of These Elements.—These points are all closely interrelated. The first four points—volume of business, the cost of the goods, the time involved in preparation for the market, and the stocks which must be carried—are fundamental in determining the amounts invested in stocks. The other points are fundamental because they effect variations in the volume of funds needed from season to season, and because they cause variations between industries. But they are likewise supplementary to the first four points, since variations in the latter affect the factors mentioned in the first four. These relations can be briefly suggested.

(1) and (2). Industries in which raw materials are expensive, as well as those which involve expensive processing to make the materials ready for market, require, first, the investment of large sums in raw materials, and, second, the invest-

ment of large sums in production, in goods in process, and in goods ready for market. Firms which have a large volume of business must likewise provide large sums for investment in goods. The relative quantities required in different industries and in different firms are primarily functions of the other points enumerated. Variations in prices and wages (point 8) affect particularly the cost of goods and the expense of marketing.

(3) and (4). It is evident that if goods are long in process (point 3) the investment in the materials being processed will be large in relation to the current output. In some industries, as in the manufacture of iron and steel and the products made therefrom—ships, locomotives, buildings, bridges—goods are in process or in storage between processes for months and often for years, before they are in the form in which final consumption takes place. In other industries, such as the canning industry, a few days completes the processing.[5] Again, if large stocks of production goods or of finished stocks must be kept on hand (point 4), a large inventory results, and so a considerable investment in stocks is necessary. This condition arises when supplies are uncertain and irregular in arrival. It is usually found when production goods come from a distance, for, in order that a constant supply may be assured, a surplus over current needs must be kept on hand near the store or factory.[6] Again, if the plant is located at a distance from the market for its finished product, or if jobbers and retailers depend upon current supplies from the factory and do not order in large quantities in advance of sales, large inventories of finished goods must be kept by the manufacturer. The iron and steel industry and the clothing industry, considering the time materials are en route and in process from mine or plantation to consumer, serve as excellent examples of industries in which large stocks of materials

[5] Even in this industry, however, growers are sometimes financed by the canners during the growing season.

[6] This problem was discussed in Chap. VI.

must be on hand. Furthermore, because of the time involved in production, large stores of stocks ready for market or near to the final stages of production must be kept in reserve to meet unforeseen demands. These conditions slow up the turnover and increase the necessary working capital and the cost of financing. When these large stocks are held by merchants the burden is simply shifted, or divided; the fundamental situation is not altered.

(5). If sales are seasonal and production involves much time, stocks must be provided, processed, and held ready for market long before they will be bought by final consumers; or if production is seasonal, stocks must be held. These conditions can be illustrated from well known industries. Since the production of cotton and wool is a seasonal industry, stocks must be held throughout the year for the use of the textile mills. The sale of clothing is also seasonal, and, consequently, much of the cloth used and many of the clothes made must be produced in advance of the seasons, if there is to be a sufficient supply of cloth for the clothing manufacturers and of clothing for the merchants. The seasonal production of lumber and the seasonal sale of automobiles are further illustrations. The canning of salmon, fruit, and vegetables, and the manufacture of sugar illustrate industries in which the goods are not long in process, but in which the production of the raw material is seasonal. Since the materials are perishable, these are held as finished products, rather than as raw materials, and are stored by manufacturers, wholesalers, or retailers. In the case of grain, the materials are held, and milling is carried on more or less uniformly throughout the year.

(6). Closely related to the problem of seasonal markets is the skill with which production and purchases are correlated with sales. This involves the accuracy with which the market demand is anticipated and the effectiveness with which the goods are sold, as well as the effectiveness with which collections are made. In case of excess production, or

excess purchases of merchandise to be sold, it may be necessary to hold goods longer than the normal period in order to avoid dumping them on the market at a loss. Or a normal supply of goods may not be sold as rapidly as anticipated, or payments may be "slow." This may be due to a "slow season" in which buyers fail to come into the market as early as was anticipated, or it may be due to the failure of the sales organization to attract buyers in sufficient numbers. In the former case the problem of carrying surplus stocks arises; in the latter, there may be the additional problem of procuring further funds with which to improve or intensify the sales campaign.

(7). The terms of purchase and sale (point 7a) affect the need for working capital to invest in materials, supplies, and the final product. When the manufacturer must pay cash for materials and supplies, perhaps even finance the production of them, and when he gives credit to those who purchase the final product, he must supply funds with which to carry the stock of materials and supplies on the one hand and the finished product on the other, as well as the other expenses of marketing. At the other extreme is the manufacturer who is given credit for his supplies and has his working capital advanced by purchasers. In his case direct financing is at a minimum. Again, the length of time for which credit is extended to customers and the time creditors extend affect the volume of current financing. It may be further influenced by the extent to which cash discounts are offered and taken.[7]

Carload freight rates and discounts offered for large purchases (point 7b) affect the volume of goods purchased at any one time, and, hence, the amount of funds needed. A large difference in freight costs between carload shipments and smaller shipments, or a large difference in price between large and small orders, frequently makes it worth while to

[7] See pp. 342–345

order in larger volume than current needs would otherwise necessitate. Larger amounts are thereby invested in stocks.[8]

(8). Finally, variations in price may have an important effect on the amount of funds needed. The large price increases of the recent war period increased the value of stocks in inventories, sometimes by more than 100 per cent. Similarly, low prices decrease the funds needed to carry on the regular volume of business. In times of abnormally high prices the requirements of business for current capital are, consequently, greatly increased. This is true even when there is no increase in the physical volume of trade. It is in such times that a great strain is placed upon the credit structure.

Middlemen and Finance: Division of the Burden.—Dealers, i. e., merchants and functional middlemen of exchange, are likewise affected by the conditions which have been discussed. But they do not have to finance goods in process of production. This is true, unless, as is sometimes the case, they help to finance the producer by allowing him to postpone payment for goods which they sell to him, or by the advancement of funds to producers or dealers whose goods they purchase.

"It is not an uncommon practice for them [wool merchants] to advance to the growers of the west, or to the small merchants of the east, substantial sums of money on consigned wool, or even

[8] It is evident that these elements simply determine how the burden of carrying goods shall be divided among those who handle them. It would be incorrect, however, to say that this division will not affect the total stock held in an industry. For the further along the line of distribution the burden of carrying goods is forced, the larger is the total inventory which is likely to be necessary. The stock is less fluid under these conditions than when it is more centrally located. When quantity prices for goods and transportation are offered, it may be uneconomical, nevertheless, to order small lots, and so each buyer tends to keep a larger stock on hand than his business would otherwise warrant.

on prospective clips, and it is sometimes necessary for the merchant to carry his manufacturer customer for months or even, in some cases, until he can realize on his manufactured product."[9]

In most industries the burden of financing and the accompanying risks are divided among the parties to a transaction.[10] The investment of funds in commodities brings with it the necessity of bearing market risks and the risks of physical deterioration. During a very large part of the journey of products from producer to final consumer this burden rests upon the middleman. In some cases, as in the canned fruit and vegetable market, the middleman is the predominating figure. In others, as in the sugar trade, the manufacturer predominates. The extent to which the burden is shifted depends in a large measure upon the financial strength of the parties to the exchange. When both parties are financially strong, business will probably be done on a cash or short time credit basis. But if a middleman or manufacturer is forced to give credit to his customers, even though he is strong financially, he is likely to endeavor to obtain credit from his sources of supply. When one party is financially weak and the other strong, it is the stronger which is likely to bear the burden of financing. Thus in the cotton grey goods trade many mills in the East buy raw cotton outright with their own or borrowed funds. Weaker mills may also stock cotton in advance, but they are likely to require an advance of funds, or to have their own weaker credit supplemented by the selling houses which handle their finished products. The evolution in the sale of harvesting machinery is also a case in point. The International Harvester Company formerly allowed considerable time, usually three years, for payment. But the increasing financial strength of the farmer was taken advantage of in 1919 and cash payments became temporarily the rule.

[9] P. T. Cherington, *The Wool Industry* (1916), p. 64.
[10] The risks involved in marketing are discussed in Chap. XVII.

The division of the finance and risk burdens is also dependent in a measure on the custom of the trade. Competitive conditions, likewise, play a part. For example, when there is a tendency to overproduction in an industry the burden of financing is likely to be shifted to the producer, since the granting of credit may be used as a selling argument and the demand is not great enough to force the financing upon the buyer. On the other hand, when demand is great, an opportunity arises for the seller to shift the burden of carrying stocks upon the buyer. This occurred through the shortening of credits during the period of the World War.

Stock-Turn and Finance.—It is a principle of sound merchandising that the investment in stock shall be as small as is consistent with the needs of the business. The stock of raw materials and supplies which the manufacturing plant has on hand or en route to its factory should be no larger than the immediate needs of the plant demand, and its supply of finished products should not be in excess of the immediate needs of its market. The stock of the merchant should be no larger than service to his customers necessitates. The ideal would be for the raw materials to flow into the factory in just sufficient quantities to meet the needs of processing, and for processing to proceed so as to turn out finished goods in exactly the quantities immediately demanded in the market. With the merchant, the ideal would be for goods to come into the storehouse just in time to be put into proper condition for immediate sale. This ideal is, however, impossible of achievement. The variable factors which make it impossible have been described. But even though the ideal cannot be fully realized, good merchandising seeks to approximate it, for, in the words of the trade, a rapid "turnover" or "stock-turn" is an essential to successful merchandising.[11]

[11] Retail stock-turn was discussed on pp. 201–205. In a factory the rapidity of the stock-turn is determined by the rate of turnover of finished goods and raw materials, and by the time the goods are in process.

II

Source of Funds and Means of Extending Credit.—Working capital with which to meet the needs previously outlined may be supplied in the following ways:

1. *By using invested capital*—funds of the firm or funds borrowed on a long time basis.
2. *By postponing payment*, and thereby shifting the burden upon the seller—through the open book account, promissory note, or draft drawn by the seller on the buyer or his bank.
3. *By borrowing funds* on a short time basis—usually from banks, either directly or through brokers.

The second and third methods are of primary interest to students of marketing.

Postponing Payment: Types of Credit.—All the methods of short time financing, except the use of a firm's own funds, involve the use of credit. Whether funds are borrowed in order to pay "cash" on purchase or soon thereafter, or whether the payment of cash is postponed by the buyer, the basis of the transaction is credit, personal or mercantile. In either case the goods must be "carried," that is, someone has to have funds tied up in them.[12] As a rule, it is the commercial bank which carries the short time debts which are created in carrying on the market processes.

[12] In the discussion which follows no effort will be made to keep separate the consideration of funds borrowed to carry on the sales and buying efforts of a firm and those invested in stock. It is evident that if goods are sold at a profit the sales expenses must be covered in the selling price, and consequently, to the next buyer become a part of the cost of the goods. Likewise, in the market as a whole, they must be considered as a part of the cost of the goods. It is true that to the firm which has the expense for its selling organization there is nothing immediately tangible to utilize as collateral for a loan, but a large part of borrowing by such organizations is, in any case, in the form of unsecured loans made upon the belief in the intention and ability of the borrower to make good, rather than on immediate tangible collateral.

There are essential differences between mercantile credit and personal credit.[13] Mercantile credit is granted by one business house to another; personal credit is granted by a business house to an individual. The latter, as a rule, enables individuals to buy goods to consume. It does not assist directly in carrying on the processes of industry, but permits the individual to anticipate his future income in order to provide for immediate needs. It does not rest on the assumption that the goods will be sold for profit by the debtor.

"Commercial or mercantile credit, however, has production in mind. It 'carries' a business transaction. It fills the void between purchase and sale. It gives the buyer time to turn the goods into money before he pays for them. It gives the manufacturer time to turn raw material into finished products before payment is due. It provides working capital. It is productive credit, and the whole process of production, transportation and distribution is based upon it." [14]

In some degree commercial credit depends ultimately upon personal credit. This is true, even though the immediate loan may be based upon mercantile credit, and perhaps upon actual merchandise pledged as security, because all production is in the end carried on to prepare goods for personal consumption. It is only on the assumption that the goods, or in the case of machinery and supplies, the goods which they help to make, can be sold for final consumption, that all business is carried on, and that mercantile credit can be arranged. And inasmuch as many goods for personal consumption are sold on credit it is evident that, to the extent that this is true, the whole credit structure rests ultimately upon personal credit.[15] For if the retailer does not carefully investigate his risks and

[13] James E. Hagerty, *Mercantile Credit* (1913), Chaps. III–V; W. H. Kniffin, *The Practical Work of a Bank* (2d ed., 1916), pp. 387–402.

[14] W. H. Kniffin, *op. cit.*, p. 395.

[15] The reasons for the growth of personal credit as outlined by Kniffin are as follows: (1) the desire of sellers to extend business, (2) the fear of offending customers by refusing credit, and (3) the "all-too-prevalent tendency to live beyond one's means."—*Ibid.*, p. 396.

gives credit to customers who do not pay, he cannot pay the jobber or the manufacturer or his bank, and these in turn may not be able to meet their obligations. In the first instance, the credit structure rests on the assumption that goods will be bought for final consumption. If this does not follow—if there is a buyers' "strike," or if particular goods fail to move—the whole credit structure suffers. But, furthermore, if the goods even when sold for final consumption are not paid for, there is the same result. It is to avoid this last possibility, as well as the cost and work involved in credit sales, that so many retailers, especially in the staple lines, have adopted the cash system of selling. Goods must be carried even though sold for cash, but the period is not so long, and the risk arising out of the possibility that goods when sold will not be paid for, so far as the retailer is concerned, is removed.

The Credit Period.—The credit period tends to conform to the times at which the debtor expects to receive the funds with which to pay. Credit for personal consumption tends to conform to the times at which the personal income is received. For example, credit to wage-earners is frequently extended for a period of one or two weeks. Those working on a salary are usually paid on a monthly basis, and from them monthly payments are expected. In the country, payments were formerly expected after the crops were sold. In more recent years the growing affluence of American farmers and their growing use of bank credit has tended toward shortening the credit period. In case the purchase involves a large amount, as in the purchase of furniture, a piano or an automobile, the period may be longer but periodic payments corresponding to the receipt of the income are usually expected.[16]

The time involved in mercantile credit tends to conform to that during which goods are in process and on the market

[16] This is done, for example, with the "dollar-down, dollar-a-week" plans, and in the monthly payment plans for buying automobiles, pianos, phonographs, furniture, and books.

before they are sold. In the case of goods which are to be sold for cash, this turnover period will include, for raw materials, the time involved in production in addition to the time necessary for their sale. With raw materials or finished products to be merchandised only, it will cover the time involved in selling the stock. In the case of goods sold on credit the period must be extended to include the time needed for collection, unless the sale can be made to finance itself, through the discounting of the promissory notes of the buyer or drafts drawn upon him.[17] In this case the goods themselves may serve as collateral. This conformation of the time of loans to the receipt of income from individual sales is, however, but rough. Sellers and buyers often borrow from the banks in amounts and for times to cover a period or a season's purchases and sales,[18] and these loans are frequently renewed from time to time.

The Security for Credit.—The security behind a credit transaction varies greatly. There are, however, two general classes of credit transaction—secured and unsecured. By this it is meant that there may be a pledge of specific collateral to protect the creditor, or that the transaction may rest merely upon the reputation and general assets of the debtor.[19]

The personal credit of retail business is usually unsecured. Neither notes nor drafts are often used. The common book account prevails. As goods are sold a charge is made "on the book" to the account of the debtor. Goods for personal use are generally sold in small quantities at frequent intervals. The effort to secure the loan by any of the methods used in mercantile transactions would involve an amount of detail and trouble out of proportion to the value of the transac-

[17] Even in this case the credit of the seller is the fundamental factor, see p. 341.

[18] This point will be discussed later; see pp. 342–346.

[19] An endorsement of the paper, note, or draft by a second party may add to the certainty of payment but such paper is considered unsecured. See Langston and Whitney, *Banking Practice* (1921), p. 286.

tion. As a result, personal credit is generally based solely on an estimate of the character and the capacity of the individual to pay. Dependence is placed on the fact that if reasonable care is used in extending credit, most bills will be met. A large percentage, furthermore, of those who receive credit have, other than the goods which are purchased, no tangible assets to pledge. And inasmuch as the goods are withdrawn from trade, and are usually consumed immediately after purchase, they cannot be used as collateral.

Personal credit is, however, sometimes secured by the goods which are sold. This may be done through a conditional sale, the seller keeping title to the goods until they are finally paid for. It may also be done by covering the goods with a chattel mortgage. The credit extended on goods sold under a partial payment plan is usually secured in one of these ways. Many installment houses do a thriving business on such a basis, taking a certain amount on delivery of the goods and requiring periodical payments thereafter, until the goods are paid for. Automobiles, pianos, phonographs, and household goods are frequently sold in this way. Machinery, automobile trucks, harvesting machinery, cash registers, and other products sold to manufacturers, farmers, and merchants are other examples.[20]

Mercantile credit, likewise, may be secured or unsecured. The unsecured "book account," common to retail trade, is likewise the most common method of granting mercantile credit.[21] But a large percentage of credit sales are evidenced by promissory notes or accepted drafts. The note is given by the buyer to the seller and the draft is drawn on the buyer or his bank, and accepted by them. Either may be held until due or it may be endorsed and discounted at the seller's bank. Finally, these notes and drafts may be secured by title to the goods involved in the transaction, through

[20] Most of this latter group should be classified as credit for investment in permanent equipment.

[21] For the reasons for this, see pp. 346–347.

the medium of a bill of lading, warehouse receipt, trust receipt, or similar document, or by depositing other collateral—as stocks and bonds.

The Seller and the Bank.—The most common way for the seller to carry the credits he grants is to borrow of banks until payment is made. This may be done by means of a direct loan from the bank, or through the sale of the seller's own notes in the "commercial paper" market. These loans are usually unsecured. The loans of those who sell on open account obviously cannot be secured by the goods themselves.[22] The seller cannot use the goods, if sold outright, as a basis for collateral. But he may take a note from the buyer, or he may keep title to the goods through a bill of lading, warehouse receipt, trust receipt, or similar document. These can be endorsed to the bank together with discounted drafts drawn on the buyer. This method is largely used in the sale of cotton, wheat, and other grains. Outside collateral, such as stocks and bonds, can also be used. But these involve the investment of the seller's own funds which he would normally put into his business. Since it is to avoid the necessity of keeping his own money tied up in the stock as well as because of the lack of funds that the seller goes to his bank, this method is not frequently used.

The unsecured note of a seller, provided he has a reputation for character and ability, and provided his business is in a satisfactory state, is commonly considered sufficient. This is particularly true in so far as the loan is made to cover current sales. Such loans are self-liquidating. That is, an actual sale of goods has been made, and the normal expectation is that the bill will be paid. If the borrower has a good credit standing, collateral is unnecessary. Should notes or drafts be

[22] In recent years there has developed the practice of advancing money against open accounts. This practice has been largely frowned upon by commercial banks, and special finance and discount houses now specialize in this work. See W. H. Lough, *Business Finance* (1917), pp. 406–410.

used in paying the seller, they may be held by him, discounted at the bank, or used as collateral. But in either case, the loan is made primarily because of the bank's belief that it can collect from the seller. It is his credit which is primarily considered.

Borrowing Funds on a Short Time Basis.—It has been shown that the buyer may pay out his own funds in buying goods; that he may borrow money with which to pay; that he may be extended credit by the seller; and that the seller may endorse and negotiate the buyer's paper, or use it as collateral for his own loans, or even hypothecate his receivables. It has become increasingly the practice, when the buyer is unable to pay for goods at once out of his own funds, for him, nevertheless, to make immediate payment. To do so he must borrow the funds. Again, even though he may be given time in which to pay the seller, it may still be necessary for him to borrow to make the payments when they are finally due.

Why is it that a buyer will borrow money with which to pay cash, rather than be carried on the books of the seller? Two reasons present themselves. The first, and generally the more important, is his desire to benefit by the cash discount. The second, is his wish to avoid dependence upon a creditor supply house.

The Cash Discount.—The cash discount is a discount from the invoiced bill which is made for immediate payment, that is, for payment on receipt of the bill or the goods, or within a short period thereafter. Thus, in some industries, sales to dealers are made on the terms, "2 per cent ten days, net thirty." This means that if the bill is paid within ten days after its receipt a deduction of 2 per cent from the face of the bill is allowed, and that in any case the bill becomes due at the expiration of thirty days. If the buyer has funds of his own, or can borrow at the market rate, say at 5 to 7 per cent, and pay this bill, it will be to his advantage to do so. Fur-

thermore, the bill is due in any case in thirty days. So the only additional financing required is to procure funds for the twenty days intervening between the tenth and the thirtieth days. Money can be borrowed at, say 6 per cent. The cash payment of a bill for a thousand dollars will result in a saving of $20 from the face of the bill. The $980 borrowed will cost, at 6 per cent for the period of twenty days, only $3.27. But if the bill is not paid within ten days, the buyer will be paying $20 for the use of $980 for twenty days. This is at the rate of $365 per year, or 37.24 per cent per annum.

Historical considerations and customs resulting therefrom seem to explain the very high cash discounts offered.[23] Before the Civil War it was customary for dealers to make trips to market at infrequent intervals, purchase goods, and pay for them on their next trip, usually at the end of six months. They gave their notes in the meantime. But with the unsettled conditions following the outbreak of the war, and particularly the unsettled times of the "greenback" period which followed, the creditor was fearful lest his customer could not pay, and uncertain as to the actual amount of money he might get when outstanding bills receivable were paid. It became customary, therefore, to offer "terms," with a high discount from the face of the bill for early payment.[24] These discounts continue to-day, partly from custom and partly as a collection device. Since they are intended to be taken, the seller discounts the proffered discount in pricing. That is, in

[23] For cash payment, a discount of 5 per cent is not uncommon. In the sale of common brick, for example, the terms are "5 per cent ten days, net 30 days." The customary terms offered in all important industries are shown in a series of eight articles entitled "Terms of Sale in the Principal Industries" beginning in the December, 1919, issue of the *Federal Reserve Bulletin* and extending through the November, 1921, issue.

[24] See W. H. Kniffin, *The Practical Work of a Bank*, pp. 464–466; see also Bureau of Foreign and Domestic Commerce, Miscellaneous Series No. 34, *The Men's Factory-Made Clothing Industry* (1916), pp. 246–251.

the case above, the seller undoubtedly considers his true price as $980. And the buyer who pays $1,000 is at a very great disadvantage in competition.

This practice makes the buyer a frequent borrower at the commercial bank. To-day, instead of making a note payable to the seller, who thereby bears the burden of financing the transaction, the buyer commonly makes out a note to his bank, or sells his "paper" in the market. In this way he obtains funds with which to pay "cash" to the seller. Single name paper sold to banks by purchasers has thus taken the place of the buyer's note to the seller which, after endorsement, the latter formerly discounted at his bank, or held until maturity. In some businesses, such as the lumber industry and the agricultural machinery trade, the older method, however, continues to be used. But in industries in which the buyer pays one price for cash and another after thirty or sixty days it is not convenient to use a note, for the principal sum cannot be known in advance.[25]

Cash Payment for Independence of Supply Houses.—There is a second reason for the tendency for the buyer to borrow funds with which to pay "cash." When a buyer is carried on the books of his supply house, or his paper is endorsed by them, or he is otherwise financed through their offices, a more or less definite obligation is thereby established. As a result of such an obligation he may be forced to continue to do business with his creditor, even though it may not always be to his best interest. In fact, such credit is sometimes extended with a distinct understanding that the debtor is to give his business to his creditor.[26] The buyer is thereby put at a disadvantage in his buying against competitors who are not thus tied to a single supply house. The same difficulty does not arise when money is procured in the

[25] For further reasons, see pp. 346–347.

[26] When commission houses in the grain trade agree to finance country shippers there is usually an agreement that all, or a certain part, of the shippers' grain shall be consigned to the commission man.

market. If the firm's paper can be sold in the open market the creditors can be paid. Consequently, they exercise no influence over the debtor's business, because of his financial obligations to them.[27]

The Buyer and the Bank.—When the buyer prefers, or is required, to pay for his goods on delivery or soon thereafter, the burden of financing is his. Well known houses can usually finance such transactions through borrowing on their unsecured paper. But some form of collateral security, particularly bills of lading and warehouse receipts, is sometimes required. This is not necessarily because the bank considers the loan unsafe. But the goods are in the hands of the buyer, and since he holds title to them, they can be conveniently used as collateral. Furthermore, a borrower may be able to secure larger advances in this way, as when produce dealers have exhausted their line of credit with their banks and desire further advances of funds. But the loans would seldom be made if the bank could not rest the further credit on its confidence in the buyer and in his ability to market the goods.

In the marketing of raw materials in particular this type of loan is important. From the time when grain or cotton, for example, is sold at the farm the goods are commonly used as the basis for loans by means of which those who own them can procure funds for making further purchases.[28] These loans, in turn, are liquidated when the product has been resold.

"The cotton buyers make arrangements with the local bankers where the gins are located, for the payment of the cotton, the banks furnishing actual cash against tickets issued by the buyer's representatives, holding the tickets in question as their collateral

[27] But many buyers cannot get funds from the bank. Their credit is so poor that only supply houses who can watch them closely will risk the danger of loss.

[28] Cotton is sometimes hypothecated, as the basis for money borrowed, or goods secured on credit, even before it has been sold by the grower.

in the meantime. When a sufficient amount of cotton has been accumulated the local banker at the request of the buyer's agent delivers the tickets in question to the local agent of the railroad, who in turn issues a bill of lading covering the shipment to compress point, which then is attached to the draft drawn by the buyer's agent upon the buyer's head office, which draft includes the price paid for the cotton plus interest and exchange charged by the local banker, who is reimbursed by the amount of the draft thus drawn. When this cotton is ready for export local bills of lading covering shipment from point of origin to compress point are exchanged by the cotton buyer's banker for local bills of lading to port or for through bills of lading."[20]

III

Particular Credit Devices.—Promissory notes and drafts are used less in American trade than in foreign trade. They are, in fact, used far less in American trade to-day than they have been in the past. Two important reasons for this exist. One is the cash discount; the other is the tendency to buy in small amounts and at frequent intervals. With the development of cash discounts, it has become the custom for dealers to make payment for goods soon after the receipt of the bill. Such sales are often carried on the books in the meantime as open accounts. With the cash discount there is an option of paying any one of two or three prices, each at a different time. The exact amount of the bill is, therefore, not known by the seller at the time the sale is made. In lines where open book accounts prevail, when a promissory note appears it is usually the note of a poor credit risk who has not met his obligations within the prescribed time. With improvements in transportation and the tendency for merchandisers to do a large volume of business on a small stock investment, shipments have come to involve relatively small amounts. It is inconvenient to settle bills for such small accounts with promissory notes or drafts. Furthermore, credits can be more

[20] John J. Arnold, "Financing of Cotton," *Annals of the American Academy,* Vol. 38 (Sept., 1911), p. 601.

closely watched under these conditions and the credit granted to any one house at one time is small. Consequently, there has developed a preference for the book account.[30]

Promissory notes occupy an important position, however, in some lines. In the sale of products of relatively large value, payment for which is made in installments—for example, equipment for farm, factory, and store—part payments are frequently provided for by obtaining notes from the buyer. The same method is sometimes used in the sale of real estate, houses, household goods, motor vehicles, and consumption goods of large value.[31]

In trades in which the buyer gives a note or accepts a draft in the purchase of goods, the seller may or may not use the note as the basis for his own borrowings. If his credit is good and if the notes are from many sources and in small amounts he may simply hold them, and borrow on his own unsecured note. In such cases the banks do not know, and cannot afford to determine, the credit standing of the note makers, but depend on the seller's credit. If his credit is not so good as is that of the note maker, or if the notes are for large amounts, he may endorse them and discount them at his bank or sell them through note brokers.

[30] Other reasons for the tendency to eliminate drafts and notes is the mitigation of the doctrine of *caveat emptor* and the substitution of implied warranties. That is, the old rule of the "buyer beware" has been changed by legal action and trade practice. There are, consequently, often adjustments in price which must be made when the quality of the goods does not fulfill the contract, expressed or implied. This is a further condition which makes it impossible to know the exact amount of a bill at the time when the draft would be drawn or the note made out. See the Brief of the Merchants' Association of New York, filed before the Federal Reserve Board, concerning the quality of paper eligible for rediscount, quoted in Kniffin, *op. cit.*, pp. 470–475.

[31] An interesting development of recent years is found in the sale of automobile paper and the rise of a special type of house to act as an intermediary between the dealer, who takes the notes, and the commercial banks. See H. G. Moulton, *The Financial Organization of Society* (1921), pp. 437–454.

Drafts.—Many transactions are financed by means of drafts drawn by the seller on the buyer.[32] These are often accompanied by the documents carrying title to the goods, such as bills of lading or warehouse receipts, and title to the goods does not pass to the buyer until the draft is paid or accepted. When a draft is accepted by the buyer it becomes virtually a promissory note, which may be discounted in the money market or held by the seller until maturity. In this latter case he may get funds, as with the promissory note, by borrowing at the bank. But there is then no necessary connection between the accepted draft and his own transaction at the bank; they are distinct. Such a draft, accompanied by the documents and accepted by the buyer, is the trade acceptance, an instrument brought into prominence since the establishment of the Federal Reserve System.[33] When the buyer makes an arrangement by which such drafts will be accepted by a bank on which they are drawn—bank acceptances—they become the easiest kind of paper to discount in the market.

Commercial Paper.—Mention has been made several times of firms borrowing money on their unsecured note rather than utilizing any form of security, whether it be the security of the goods themselves or the note or draft of the buyer. When such paper is sold in round denominations for a definite period of time, to banks, or through note brokers, or to commercial paper houses for resale to commercial banks or other investors in the open market, it is called "commercial paper." Paper which has its origin in actual commercial operations is also called commercial paper. This latter class of paper has been given great emphasis under the Federal Reserve System. The characteristics of such commercial paper, as laid down by the Federal Reserve Board, are that it shall be paper drawn for agricultural, industrial, or commercial purposes. In in-

[32] In Europe and in foreign trade, commercial transactions are quite universally financed in this way.

[33] See Moulton, *op. cit.*, pp. 162 ff.

dustrial and commercial transactions it must not run for more than 90 days; in agricultural transactions 6 months is allowed. And the notes must be self-liquidating, that is, drawn for the purpose of moving commodities to market. It is further assumed that the sale of the commodities involved will furnish the funds with which to pay the notes.

Cold Storage Finance.—An interesting variation in market finance is found in the case of products held in cold storage. There are many small dealers with relatively small capital who purchase eggs, for example, in the spring and hold them over into the fall and winter. They, like many other buyers of eggs, place their stock in a cold storage plant. To finance their operations they borrow from the cold storage dealer, giving control over the title to the eggs in storage as security. But the cold storage plant does not furnish the money; it in turn utilizes its own credit, with the eggs as collateral, and borrows from the banks. The dealer thus acts not only as a functional agency for the storage of products, but as a functional financial middleman as well.

CHAPTER XVII

MARKET RISK

I

Market risk is due primarily to fluctuations in prices. That is, price changes cause actual loss, or the loss of potential profit, to those who own goods and to those who must purchase them. If, for example, the price at which a farmer sells his grain is higher than the cost of producing it, the farmer gains; but those who purchase are forced to pay the higher price. If they had anticipated a lower price, potential profits decline, or actual loss results to some or all of them. But when the price is low the gain is theirs, and the loss is sustained by the farmer. All producers bear risks of this kind. And all middlemen, particularly merchants, are confronted by them. Anything, then, which affects the demand or supply for a product, or which brings about a maladjustment of demand and supply, such as poor crops, deterioration of goods in storage, style changes, influences its market price, or the price of particular lots of it, and may thereby cause loss to some and gain to others. It is the danger of loss from circumstances which are not foreseen that is here called market risk.

Time Risks.—In most market transactions the risk involved is due to the passage of time. Goods or services are bought with the hope or expectation that they can be sold later at a price that will net a profit, but in the meantime prices may fall or the product may deteriorate. The merchant incurs such a risk when he buys a product in the wholesale market for later sale in the retail market; the retailer runs

a similar risk in buying from the jobber, expecting to sell at a profit to the consumer. But if consumers will not buy at a price that is profitable to the retailer, he must stand a loss. He may even be unable to pay the jobber for the goods. In any case he will be unwilling to buy at the old price, and, perhaps, in the former volume. The jobber, nevertheless, may have already bought from the producer, and so he, in turn, suffers loss. The producer incurs a like risk, for he must use capital, labor, and raw materials in producing his product, although by the time it is ready for market there may be no demand, or such demand as exists may be at a price so low that loss will ensue. The man who buys a house runs a risk that real estate values may decline or architectural styles may change. And he may find consequently, that his house is not salable at a profit, or, if he bought it for a home, that it does not give him a degree of satisfaction corresponding to the investment. So any investor incurs a risk that the value of an investment will decline until his income therefrom is smaller than he had anticipated, and that the principal sum may be partially or completely lost.

Place Risk.—Place risks are now minimized. Market news spreads so rapidly that in well organized markets it is seldom possible to buy goods in a market where prices are low, transport them to a market in which prices are higher, and there sell at an extraordinary profit. Neither is it likely that goods purchased in one market will have to be sold at a heavy loss in another market, simply because prices are lower there than in the first. This is because of the fact that such gains or losses as these can arise only out of the lack of knowledge of conditions in one market by those who are in another. But in dealing with markets which are not highly organized, with perishable commodities, or with ignorant people, profits may be taken and losses occur because prices in different markets are out of line with one another. That is, the different price levels are due to the fact that the commodities are in different places, rather than to the fact that a period of

time has elapsed during which prices for the commodity have changed in all markets.

The Influence of Roundabout Production on Risk.—The roundabout method of production makes the time element particularly important, and so is an important cause of market risks. Production commonly involves fixed investments and heavy expenditures which may have to be made years before the proceeds can be expected to return profits or to safeguard the principal; and it frequently takes months to prepare a product for market. A steel manufacturer hires labor, buys land, constructs a plant, and procures materials with which to make steel to sell to a manufacturer of machines. The manufacturer of machines in turn has invested with the expectation of selling his machine to a manufacturer of bicycles, and the bicycle manufacturer purposes to sell his product to the public. But in the meantime automobiles and motorcycles are put on the market at prices which curtail the profitable demand for bicycles. This necessitates a readjustment all along the line.

Of course, it is true that the plant of each manufacturer can be adjusted to the new needs of the market. But this may involve expenses which were not anticipated and which some of the manufacturers may be unable to meet. Other manufacturers, furthermore, may have foreseen the change that was to take place and have taken the cream of the new market themselves. If those who were less successful in their forecast of the market succeed in gaining an adequate demand, it may be only at an excessive selling cost.

Or in an even more frequent case, a manufacturer of automobiles may estimate that he can make a certain number of sales during the season, and so prepare to produce an equal number of cars. But when the season opens, although he has a large stock ready to ship and materials and equipment and labor for making more, his cars may not sell as rapidly as he had anticipated; or perhaps the demand for his automobiles may be good for a time, but eventually he may lose business

to competitors or to the manufacturer of aëroplanes. Again, hard times may depress the market, or transportation facilities prove inadequate to bring supplies to the plant and move the cars to the market.

A large part of the investment in modern industry is relatively permanent, and often cannot be salvaged after unfortunate market changes, except by changing the equipment and the product manufactured. This may involve great expense and even then the market may not be large enough to take the new output at a price that will net a profit. If the new product does not appeal to the public, or if the plant cannot be readily transformed, it may even be necessary to sell the plant at a considerable loss. In addition, surplus stocks containing the results of large investments in labor, materials, and capital may lie in the warehouse unsold, or they may have to be sold at less than cost. It is evident that, since the investment and expenses of many producers anticipate the market for years ahead, an error in judgment or a change in conditions may result in large losses.

Risks of Competition.—A general change in demand is not the only market risk that the producer must face. A competitor may revise his method of manufacturing so as to improve the quality or lower the costs of his merchandise, or he may improve his methods of selling. In consequence, prices may be cut and demand be diverted by competitors until a particular producer, if he cannot utilize the same or equally successful methods, is forced to sell at a loss or even to go out of business. Merchants likewise have this to contend with. The indifferent country storekeeper finds that he is losing his trade to an up-to-date competitor around the corner, or to the mail order house, or to the new branch of the chain store; or that the interurban and automobile make it possible for his customers to trade at the city near by. Finally, risk arises because the consumer is a complex individual with variable likes and dislikes whose demands are easily influenced through education, changing environment, styles, fashions, seasons, and

the efforts of vendors to create demand; and whose purchasing power is altered through changes in status, local prosperity, depressions, panics, and crises.

Other Risks.—Enough has been said to show that business is an undertaking involving great risk, risk which arises primarily out of market conditions. But there are two other familiar classes of risk to which the business man is subject, and which may have a very direct effect on his marketing activities and their financial results. There are what may be called natural risks: rain, wind, lightning, hail, earthquakes, disease, vermin, heat, and cold. And there are other risks which arise partially, or wholly, out of the human element and only partially from natural causes: fire, accidents, losses at sea, losses from bad debts, dishonesty (moral hazard), incompetence, strikes, and lockouts.

II

Some Methods for Minimizing Risk: Prevention.—Effort is constantly being made to eliminate risk altogether, or else to minimize its effects. A great part of this effort consists in shifting some part, or all of the risk to others who are more willing or better qualified to bear it. Another important method of dealing with risk is to do away with its causes, or at least to minimize the chances ~~of the~~ loss. Insur~~ance and~~ hedg~~ing are important examples of~~ the first. Examples of the second include the following: an increase in the knowledge of market conditions on the part of business men, with a corresponding decrease in the purely market risks; the construction of fireproof buildings and fire escapes to decrease the fire hazard; safety vaults, police systems, burglar alarms, and the inculcation of ideals of honesty to minimize losses from burglary and theft; mechanical safety devices and education in "safety first" to reduce the number of accidents; and education in effective business methods to reduce the risks from incompetence.

Minimizing Market Risks.—It has been shown that the risks which arise from the market are due to unexpected changes in the demand and supply of commodities. These risks are particularly important to modern specialized producers. Since they produce in advance of the final demand for their product, it is evident that loss may result either from a reduced demand or an increased supply of the goods they are producing. Among the more important means of reducing such risks are:

1. Government regulation and guaranty of price and service.
2. Effective sales efforts.
3. Associations and combinations among competitors.
4. Knowledge of the market.
5. Shifting and dividing risk.

When the government guarantees a minimum price for wheat, the risk of loss from a lower price is removed from the farmer.[1] When a maximum price for the railroad rate between two points is definitely established the risk to the manufacturer of paying a higher rate than had been contemplated when prices were quoted or when orders were taken is eliminated. When rebates are made illegal, and the law is enforced, small manufacturers are saved from the loss that may arise from a larger competitor's ability to undersell them because he receives rebates.

Goods may be advertised extensively with a view to increasing or maintaining demand and avoiding the risk of substitution. Buyers are made familiar with certain trade-marks and brands through advertising, until there is little danger that the manufacturer will lose a sale through the substitution by the retailer of another product which the consumer ignorantly accepts as the one he asked for. If the seller can convince the buyer that his product is the best, he has removed a large part

[1] It is, however, shifted to the government. If the guaranteed price causes over-production a greater social loss occurs than would have otherwise been felt.

of the danger that any other product will be substituted. Even though this may not be possible, selling effort may, nevertheless, create a favorable attitude of mind which makes later sales efforts more effective. Through such means markets are maintained or improved, and the risk of loss from a declining demand is reduced.

3) The ~~formation of associations and~~ combinations among competing firms tends also to reduce market risk. An understanding ~~among competing~~ manufacturers that they will allow ~~but 30~~ days' credit reduces the credit risk and regulates competition in credit giving. An agreement to sell fresh fruits at prices established by a local grocers' board does away with competition which might be manifested in price-cutting; an agreement to make but two deliveries a day, or the establishment of a coöperative delivery service lessens competition in delivery service, and so, as in the last case, narrows the field of competition and makes it easier to estimate and control. An agreement among paper manufacturers to allot territory among certain manufacturers on an agreed basis, or to limit production to an agreed maximum, likewise limits risks. An understanding among competing coal or oil producers to follow the prices of a particular large operator stabilizes price competition; so do the activities of open price associations.[2]

Again, when a manufacturer or dealer buys up strong competing manufacturers or dealers, he thereby removes competitors, and so reduces the risk in his market. Perhaps the chief object of the so-called "trusts" has been to reduce or to remove entirely certain risks of the market, with a particular view toward eliminating the risks that arise from competition.

4) *Minimizing Risk Through Knowledge ~~of the~~ Market.*—Since market risks arise from changes in the conditions of demand and supply an important means of reducing them is to obtain a correct knowledge of the market, present and future. If a manufacturer knows there is to be a shortage of raw material which is essential to his business, he is likely to

[2] See pp. 389–390.

go into the market early in order to buy it as cheaply as possible, or even to make sure that it can be procured at all. On the other hand, if he knows that the price of that raw material is likely to go down in the immediate future, he will wait until it is actually needed before ordering so that he can take advantage of the lower price. It is to avoid risks such as are here suggested that the various means of assuring a supply of raw materials described in Chapter VI are used. The more knowledge the merchandiser has of market conditions, the more his plans can be made to conform to actual market conditions as they unfold. Market risk is thereby reduced.[3]

With the rapid perfection of the means of communication and the accompanying increase in the knowledge of market conditions, it would seem that market risk could be increasingly minimized. But industry and commerce, on the other hand, are constantly growing more complex and market conditions more difficult to forecast.[4]

Shifting Risk.—Government assistance, effective sales effort, coöperation or combination among competitors, and accurate market forecasts are all important means for lessening market risks. But in many cases they are not available or not effective. This is particularly true of market forecasts. For, even with the best available market news service, forecasts of the market are far from accurate. Thus, of the factors affecting demand, many cannot be predicted far enough in advance to remove risk from the producers and merchants who undertake to supply our needs. For example,

[3] For further discussion of market news see Chap. XVIII.

[4] Thus it seems unquestionable that our recurring crises arise fundamentally out of a lack of information of the market on the part of large numbers of business men, and commercial crises are relatively modern phenomena. It may be that we shall eventually reach a condition where our knowledge of the market will be sufficient to eliminate such phenomena entirely; but it is doubtful whether that will occur until industrial change becomes less rapid than it is today. See W. C. Mitchell, *Business Cycles* (1913) and *The Business Cycle* (1921), a reprint of articles published in the *New York Evening Post.*

natural causes which affect the market are very important, but they are not predictable with any degree of certainty. A cold winter causes a fuel shortage because demand is greater, and transportation may be tied up; a warm winter means a smaller demand. A cold spring reduces the demand for seasonable clothes and foods. Again, the uncertainty of human desire makes a correct anticipation of the market difficult. A "buyers' strike" may develop which will cause a decline in the demand for all kinds of goods, or it may be directed at specific commodities—as some of the attempts of women's organizations to prevent the purchase of high-priced butter and eggs during the winter months. But this difficulty is particularly important in the sale of style goods. Styles may be incorrectly forecasted or popular styles may decline in favor more rapidly than was anticipated. Finally, the sales efforts of some competing firm may prove to be so effective that they divert demand from other producers.

On the side of supply, two very important factors are commonly difficult to forecast. One of these is the volume of goods which competing producers are going to have for sale. This is particularly difficult to forecast in a small scale industry, such as agriculture. A large crop of cotton may lead to a general understanding that a smaller crop should be produced, but no one could be certain until after planting that the suggestion would be generally observed. The second factor applies particularly to farm products: the volume of production is in a great degree beyond human control, for the action of natural forces in determining the amount and the quality of a crop cannot be accurately predicted.

Since many market risks cannot be avoided, they must be borne by someone. But they may often be shifted from the shoulders of individual entrepreneurs by means of contracts, or divided among them by means of insurance.

The Contract Shifts Risk.—Risks are commonly shifted by contracts of purchase and sale. An illustration of this method

of shifting risk can be taken from the building industry.[5] A corporation desires to construct an office building. After it has decided upon the plans, it may call for tenders from contractors. The contractors make their estimates on the basis of their knowledge of the construction business, and of such factors as the cost of materials, the conditions of the labor market, and the time of year. Then, when the contract is let, the successful contractor, probably on the basis of previous understandings on which he has based his original estimate, may proceed immediately to let sub-contracts for materials and for the construction of certain parts of the building. He contracts to buy cement, sand, stone, and steel, with which to construct the reënforced concrete parts of the building; he contracts for the plumbing and the wiring with other contractors, who in turn contract for the materials they will use. In this way the original contractor avoids all risk to himself save that arising out of the possible failure of some of those with whom he has contracted to meet their obligations, and those which arise out of incorrect estimates he may have made regarding the time of constructing his own part of the job, and concerning his own expenses for labor, materials, and management.[6]

Contracting Minimizes Total Risk.—Risk is shifted in such instances; but it is also minimized. Each one with whom contracts are made is supposedly an expert in his special field. Expert knowledge of the market insures, consequently, that materials will be bought under the most favorable circumstances. This enables each specialist to offer a price that is

[5] See also pp. 101–102.

[6] In times when deliveries are uncertain, and prices and wages are tending to increase rapidly, contractors are often unwilling to contract to deliver at a stipulated price. Under such circumstances they may shift the risk upon the party desiring the building by agreeing to construct it at cost plus an agreed lump sum, or for a certain percentage of cost. The cost-plus contracts with the government during the World War arose in part out of such conditions.

lower than that which the general contractor would have based his estimates on had he himself been forced to take the entire risk. Knowledge of the various markets involved in the construction of the building is very much greater under these circumstances than it would be if the original contractor should forecast all the markets and bear all the risk. Consequently, the total risk is less. Furthermore, the averaging of risks by those who contract reduces the danger from a failure to anticipate adequately future conditions in a particular case. This is especially true of those who provide materials. They know that there will be losses on an order now and then but that there will be greater profits on other orders than they had anticipated. In a competitive business, consequently, prices will be quoted that are lower than they could otherwise be.

Similar examples are found in merchandising. The manufacturer who has sold his output for a year in advance has removed risk on the demand side of his market. If he contracts for raw materials he has removed risk on the side of supply.[7] The farmer who sells his crop before it is harvested, or even before it is planted, has removed risk on the demand side. Those who make such contracts may forego the chance of larger profits from a market offering higher prices at the time they are called on to deliver, but they also remove the risk from a falling market.

Middlemen and Market Risk.—It has been shown in earlier chapters that middlemen perform an important service in bearing market risks. Raw material merchants buy directly from producers, frequently before contracting for resale. Merchants are very important in the marketing of farm products. Most agricultural products are ready for market in great quantities during short seasons, and the function of carrying them over so that they may be consumed uniformly

[7] This is, of course, on the assumption that contracts will be fulfilled, and without recourse to the courts.

throughout the year is performed in large measure by wholesale merchants. Manufacturers and other merchants sometimes contract with these merchants for materials not yet in their possession, so that their risks arise from both the supply and demand sides of the market. Merchants who wholesale manufactured products commonly buy, or contract to buy, goods before they are sold to retailers, and in other cases contract to sell to retailers before they have the goods. Finally, retailers contract for and stock goods which consumers have not ordered. The merchant is thus important in making it possible for producer and consumer alike to shift risk. As a specialist in distribution with an expert knowledge of his markets he is peculiarly fitted to do this.

The Residual Risk.—But risk which is shifted must be borne by some one. The manufacturer and the wholesale merchant may shift a large element of risk by offsetting contracts to sell by contracts to buy, and *vice versa*. But the "original" producer of raw materials and foods and the retail distributor can seldom do so. The farmer, for example, normally produces in anticipation of demand. Only in rare instances has he contracted to sell before production begins. At the other end of the distributive system the retailer can seldom shift the risk he bears. He buys in anticipation of consumer demand. If that demand fails to materialize he must suffer loss.

Organized Dealing in "Futures."—The shifting of risk by means of the purchase and sale of contracts for future delivery is so important that the future markets in some trades center in organized exchanges which facilitate and control transactions of this kind. Exchanges have become very useful in the market for certain staple raw materials, particularly grain and cotton.

These organized exchanges afford a mechanism widely used in shifting market risks. The principal organization features of the ordinary exchange may be briefly summarized. The

object of the organization is to facilitate the market activities of its members. It does not buy or sell products as an organization. But it provides a place in which trading can be carried on. Some exchanges are formed to regulate and facilitate dealings in a wide variety of merchandise, but others confine their activities to a narrow range of products or even to a single one. Examples of the first class are the Boston and New York produce exchanges and the Chicago Mercantile Exchange. The Chicago Board of Trade and the Minneapolis Chamber of Commerce are examples of those in which dealing is confined to a few products, chiefly grains. The New Orleans and New York cotton exchanges are confined to trading in a single commodity. Many exchanges, however, do not provide for future trading.

The chief functions of exchanges as they relate to trading in contracts for future delivery ("futures") are:

1. To provide a trading place.
2. To determine who may be members and who may use the exchange.
3. To regulate business dealings.
4. To establish uniform grades for products and a system of inspection.
5. To assist in settling disputes.
6. To acquire and disseminate market news.[8]

Shifting Risk through Hedging: Terminal Elevators.—That a trader may gain or lose as a result of transactions on the exchange is evident without illustration. But that loss

[8] For more detailed descriptions of the organized exchanges the reader is referred to any of the following: H. C. Emery, *Speculation on the Stock and Produce Exchanges of the United States*, Columbia University Studies in History, Economics, and Public Law, Vol. VII (1896); H. H. Brace, *The Value of Organized Speculation* (1913); James E. Boyle, *Speculation and the Chicago Board of Trade* (1920); L. D. H. Weld, *The Marketing of Farm Products* (1915); *Report of the Federal Trade Commission on the Grain Trade* (1920), Vol. V.

may be avoided by operating on the future market is not always realized. This is accomplished through what is called "hedging." Hedging involves contracting to purchase or sell in the future market at the same time that a regular business transaction of an opposite nature is started, which is also to culminate in the future. That is, a purchase of goods to be sold later is offset by a sale of goods for future delivery to be purchased later in the "future" market, or, *vice versa*, a sale is offset by a purchase. This is done on the assumption that prices in the cash and future markets tend to move together. Hedging is not confined to the exchange organized for future dealings. It is simply facilitated thereby.

One of the most important examples of hedging is found in the operations of the terminal elevator companies of the grain trade. These merchants buy grain as it comes from the country districts during the fall and hold it over until it is wanted by the mills or by other buyers. Since millions of dollars' worth of grain are handled in this way by a single dealer, it is evident that a very small change in price might result in enormous loss or even bankruptcy.[9] To take this chance the elevator company would be forced to pay less for the grain in the first place, for it could not take the risk of such losses without the opportunity likewise to make large offsetting profits. The existence of a future market for wheat, however, through the system of hedging, enables the elevator to protect itself against just such losses. For wheat bought on the cash market can be immediately hedged by making a sale on the exchange for future delivery. This reduces the likelihood of loss, and so the elevator can safely pay a higher price for the grain it stores. The elevator's profit is the difference between the price paid for the grain, and the future price at which the hedging sale was made, after deductions are made for the cost of carrying the wheat, interest on plant,

[9] Many single elevators have storage room for more than a million bushels, and some of the grain companies own several elevators.

insurance, organization expenses, and so on. If the cash price is too high at a given time as compared with the future price, it is evident that the terminal dealers will not find such transactions profitable.[10]

Contracting for Future Delivery.—A few illustrations of the way in which such protection operates will assist the discussion. In each of the illustrations it has been assumed that the cost of carrying the grain from September to May plus a reasonable profit is 5 cents. It is also assumed that the grain originally purchased was delivered to meet the future contract to deliver. But the elevator need not, as a matter of fact, and usually does not, hold the cash grain it buys to make delivery. This will be shown later. But it makes the later illustrations more easily understood to assume at this point in the discussion that actual delivery of the original grain is made. When that is done, however, the transaction is really no different from the contracting method previously described.

Case 1

Bought cash wheat September 10 at $1.50. Sold September 10 for May delivery at	$1.55
May price at which wheat could have been sold on the cash market had the elevator not sold on September 10	1.55
Loss or gain, without future contract	$0.00

Case 2

Bought cash wheat September 10 at $1.50. Sold September 10 for May delivery at	$1.55
May price at which wheat could have been sold on the cash market had the elevator not sold on September 10	1.65
Profit foregone through future contract	$0.10

[10] See, however, the *Report of the Federal Trade Commission on Wheat Prices for the 1920 Crop* (Dec. 13, 1920), pp. 52–59, where hedging with the future price of grain below the cash price, and fluctuating rapidly and within a wide range, is described. See also pp. 370–371

CASE 3

Bought cash wheat September 10 at $1.50. Sold September 10 for May delivery at	$1.55
May price at which wheat would have been sold on the cash market had the elevator not sold on September 10....	1.05
Loss avoided through future contract	$0.50

Trade and Speculative Profit.—To understand the advantages that arise from transactions of this kind it is essential to distinguish between what is called "trade profit" and "speculative profit."[11] The former is the profit which a merchant expects to get for performing his part of marketing. Thus, the terminal grain dealer's service is to hold grain over from periods of abundant production for use in periods of scarcity. The trade profit of the dealer who hedges arises out of the difference between the price at which cash grain is bought on a given day and the price at which future grain is sold on that day.[12] Because the price of grain may fall before he sells his grain, the dealer hedges. His trade profit is thereby protected. He foregoes, however, the opportunity of making a speculative profit which would arise from a favorable price change. The manufacturer, likewise, who fears loss because of price changes may protect his manufacturing profit by dealing in future contracts.[13]

In the illustrations given these situations can be traced. In every case, the terminal elevator bought wheat at $1.50 and immediately sold it at $1.55 for future delivery. The

[11] See S. S. Huebner, "The Functions of Produce Exchanges," in the *Annals of the American Academy of Political and Social Sciences*, Vol. XXXVIII (1911), pp. 342 ff.

[12] But see p. 370.

[13] See the statement of F. M. Crosby before the Committee on Agriculture, House of Representatives. Jan., 1921. This can be found in *Futures Trading*, a pamphlet published by the Chicago Board of Trade, pp. 29–49.

profit from such transactions arises from the fact that the cost of carrying the grain from September until delivery is due in May will be less than the margin between the cash and future prices at which the elevator bought and sold. In the first case, hedging was unnecessary, for when May came the cash price was $1.55, the price the dealer had anticipated as necessary to net him a profit. In the second case, a speculative gain of 10 cents was lost as a result of hedging. For although the cash price was $1.65 the dealer's grain had been sold at $1.55. But in the last case the cash price had declined to $1.05. If the elevator had not hedged, it would have lost 50 cents a bushel in addition to the cost of carrying the grain. It is to avoid such losses as this that the hedge is used.

The Country Elevator Hedges.—The country elevator may likewise hedge. Some time always elapses before grain can reach the market. Furthermore, the elevator may wish to hold it, or may be unable to get cars in which to ship it. Whatever the cause, if time must elapse between purchase and sale of grain, there is danger of loss.[14] When the grain is finally sold, the country elevator owner has no more need for the hedging sale, since his own grain is sold. But until he cancels this hedging sale, he bears the risk of a rise in price on the grain he must purchase to meet his contract when it is due.[15] To avoid that risk his representative on the exchange purchases the same amount of wheat for delivery at the date

[14] It is by no means the universal practice of country elevators to hedge. And elevators may hedge only a part of their purchases, and speculate with the others. Often grain is sold as soon as it is purchased. But the need to hedge is not eliminated. It is simply shifted to the new buyer who then bears the market risk. For discussion of the prevalence of hedging among country elevators see the *Report of the Federal Trade Commission on the Grain Trade* (1920), Vol. I, pp. 213–214.

[15] Delivery will not be due on the future sale until the future month in which the contract comes due arrives. The grain in the elevator's hands is, however, commonly sold before that time arrives.

his future sale is due.[16] An illustration of the normal situation will make this clear. The order in which the transactions occur is shown by the numbers in parentheses.

Purchases		*Sales*	
(1) Bought cash wheat September 30 at	$1.50	(2) Sold for December delivery September 30 at	$1.52
(4) Bought December wheat October 10 at	1.52	(3) Sold cash wheat October 10 at	1.50
Total purchases	$3.02	Total sales	$3.02

The dealer buys grain when the price in the central market is $1.50 and hedges by selling for future delivery, say December wheat at $1.52. In a few days his grain is at the market, and it may be that the same prices prevail. In that case he can buy in his hedge at the same future rate and sell his grain at the same cash rate which prevailed when he made the original transactions.[17] If prices have fluctuated in the meantime, however, and the price of cash grain has gone down, the actual grain must be sold at the lower cash price. But, since future prices and cash prices normally vary in the same direction, he can buy in his future at the lower price likely to prevail for futures and so maintain his profit. It is such a contingency which is hedged against. In other words, nothing is made or lost on the future transactions.[18] That is the aim, for the shipper's profit is made from his trading activities

[16] An operation of this kind is fully described, *op. cit.*, pp. 208–213.

[17] As the central market prices only are used in the illustration no profit to the country merchant is shown. But the price at which he buys from the farmer is normally less than the cash price in the central market, in this case $1.50, by the cost of handling and shipping plus his profit.

[18] Some expense is involved, of course, but it is principally the brokerage fee paid the elevator's central market representative for carrying out the hedging operations on the exchange. There is also danger of a change in the spread between the cash and future price.

at the country market. A transaction carried out under these conditions is shown below.[19]

Purchases		*Sales*	
(1) Bought cash wheat September 30 at	$1.50	(2) Sold for December delivery September 30 at	$1.52
(4) Bought December wheat October 10 at	1.42	(3) Sold cash wheat October 10 at	1.40
Total purchases	$2.92	Total sales	$2.92

Manufacturers May Hedge.—Hedging is also practiced by manufacturers. The miller may buy wheat in September to manufacture into flour to be ready for sale in April. If at the time he buys the grain he can sell the flour for April delivery, the contract of sale will assure that profit will result from his manufacturing operations, assuming that he sold at a price which would net a profit on the milling operations. Again, he may sell flour for future delivery, estimating the costs on existing market prices. He can then go into the market at the same time and buy wheat for future delivery. In either of these cases the profits are protected: in the first, against a fall in the price of flour; in the second, against a rise in the price of wheat.

But if the miller buys wheat in September to manufacture into flour and cannot sell it for future delivery,[20] or if he sells flour for future delivery and has not purchased the wheat, he may hedge in the future market by purchasing wheat for

[19] The terminal elevator, also, usually sells its grain and buys in its hedges before the future contract matures.

[20] This is the usual situation early in the crop year. In this country, for example, grain moves east from the growing areas. As it passes through various milling centers the mills, or merchants, must purchase enough grain to meet future needs—when grain is less plentiful. If mills wish to be assured of grain with particular characteristics they must buy early or they may be unable to purchase it later, except at a high premium. Because of these facts most mills do buy early, and possess a large storage capacity.

future delivery. Generally speaking, the price of flour follows the price of wheat, so that by the sale or purchase of wheat for future delivery on the basis of existing prices, any important changes in the price of flour can be hedged against. If the prices of flour and wheat go down in the meantime, a loss will result to the miller who has not sold his flour, because the wheat he bought at a higher price will have to be sold as flour at the reduced price. If, however, when wheat was bought in the first place a sale of wheat was made for this future date, the grain to make the delivery could now be bought at a lower price. But it would be delivered at the higher price at which the future was originally sold. The grain on this transaction compensates for the loss on the wheat made into flour. When the miller sells flour but does not possess the wheat he may protect himself by buying wheat for future delivery.[21] By these transactions loss is minimized. But similarly, of course, any speculative gain that might have resulted from the original purchases or sales will likewise be eliminated. In other words, the miller will make only his manufacturing profit; no speculative profit or loss of importance will result.

Cotton manufacturers sometimes buy cotton from merchants before the crop has matured, and the merchant may in turn buy it from other dealers, simply taking a trade profit for his activity in caring for the manufacturer while shifting the actual speculation to the other dealer. And manufacturers in a number of lines may to some degree avoid risks in their market by buying and selling for future delivery raw materials which they plan to use.

Other Benefits from Hedging.—Even the farmer benefits greatly from hedging, although he does not usually take an

[21] The miller will probably not use the actual wheat purchased, for it may not prove to be of the quality desired. He will go into the market and get the quality he wishes and sell the future previously purchased. The loss or gain on the one transaction thus tends to counteract the loss or gain on the other.

active part in it.[22] It is evident that without hedging, grain, for example, could not be dumped on the market by the farmer in so short a time as it is without enormous risks being run by those who buy it. When buyers cannot adequately hedge against price declines, they have to discount the possible loss from price changes in order to cover the larger risk they bear. They cannot bear the risks without a wide margin between the price they pay the grower and the price which prevails in their selling market.

Financing is rendered safer when crops can be hedged. Bankers hesitate to finance speculative undertakings and consequently will not loan a large percentage of the present market value on unhedged crops. Bankers in central markets in particular often require merchants to whom they loan to hedge their transactions when that is possible.[23]

All Risk is not Eliminated.—It must not be assumed, however, that hedging removes all danger of loss. As the delivery month approaches the tendency is for the cash price and the future price for that month to approach each other. In other words the "spread" between the cash price and the future

[22] Boyle states that in August, 1919, when the price of corn began to fall many large farmers, assured of their crop, sold it for future delivery. In this way they protected themselves against any further drop in price which might take place before their own crop was harvested. See J. E. Boyle, *Speculation and the Chicago Board of Trade*, p. 36.

[23] "The millers and the grain men, buying . . . much larger quantities of grain than they require for their immediate purposes, are compelled to borrow money entirely out of all proportion to the amount of capital which they have invested in their business. These loans are sometimes secured by warehouse receipts for grain, but as the price of grain may decline very sharply and suddenly, the conservative banker cannot depend entirely upon the grain as security, but must insist that the borrower hedge his purchases, either through the sale of flour or the selling of futures on one of the grain exchanges, thus insuring both the borrower and the banker against severe fluctuations in the value of the grain." This is a paragraph from a letter written by Mr. F. O. Wetmore, President of the First National Bank of Chicago, and printed for the Chicago Board of Trade.

price tends to narrow. Now when the hedging transaction compels the operator to go into the market to buy or sell, a slight variation in this spread may cause him to lose or gain, as the case may be. This can be illustrated in the case of the country elevator. Suppose it buys on a $1.50 basis and sells its future on a $1.57 basis, and that when the wheat gets to market the cash price has gone up to $1.53 and the future to

Purchases		*Sales*	
(1) Bought cash wheat September 30 at	$1.50	(2) Sold May wheat September 30 at	$1.57
(4) Bought May wheat October 30 at	1.60	(3) Sold cash wheat October 30 at	1.53
Total	$3.10	Total	$3.10
		Gain or Loss	$ .00

$1.60. No gain or loss is evident. But suppose that in the meantime the spread narrows; it is then evident that, as a result, a gain has accrued. This is, of course, the normal

Purchases		*Sales*	
(1) Bought cash wheat September 30 at	$1.50	(2) Sold May wheat September 30 at	$1.57
(4) Bought May wheat October 30 at	1.56	(3) Sold cash wheat October 30 at	1.50
Total	$3.06	Total	$3.07
		Gain	$ .01

result, since cash and future prices tend to converge as future months draw nearer. Although the change in the spread would theoretically be small in the short period of time normally elapsing before the grain reaches the market, it may actually be very great, and may either increase or decrease. Had the spread widened a loss would have resulted, as is shown on page 372. But such losses are usually relatively small, and unless prices are greatly "out of line" they are not to be

Purchases		*Sales*	
(1) Bought cash wheat September 30 at	$1.50	(2) Sold May wheat September 30 at	$1.57
(4) Bought May wheat October 30 at	1.58	(3) Sold cash wheat October 30 at	1.50
Total	$3.08	Total	$3.07
		Loss	$ .01

compared with the risk of loss through changes in prices when no hedge is made.[24] Terminal elevators sometimes increase their profit by buying in their hedge at times when the spread narrows more than is normal. This will increase their profits, because, as it will be remembered, the spread at the time they bought cash wheat and sold it for future delivery was enough to cover the costs of carrying it in addition to some profit. And so, if the spread at the time of sale has narrowed more than the normal amount, the profit is increased by so much. They can buy again when the spread becomes normal.

Speculation.—Hedging is most successfully carried on in the sale of products which are traded upon exchanges organized for future dealing. On such markets the play of demand and supply tends to keep the spreads between markets and between present and future prices normal, that is, at an amount just sufficient to cover the cost of carrying the product to the future time, or from market to market. It seems, furthermore, that hedging depends for its greatest usefulness upon pure speculation, that is, on buying and selling which are done only for the purpose of making a speculative as opposed to a trade profit. It is asserted that such speculation on the exchanges cannot be prohibited without making impossible the most efficient hedging. There is much difficulty, for example, in learning who is speculating. In a given trade both parties may be speculat-

[24] During the spring of 1920, however, largely because of transportation congestion, the cash price was often higher than the future price, and delivery was so uncertain that hedging could not be so readily and safely indulged in. See *Report of the Federal Trade Commission on Wheat Prices for the 1920 Crop*, pp. 52–59.

ing, or only one may be speculating, or neither may be speculating. Furthermore, if speculative trading were prohibited it is likely that the future market would be far less efficient than it is now. For seldom do the desires of "real" buyers and sellers coincide. Thus terminal elevators, which are "legitimate" sellers, might be selling heavily at certain seasons, whereas millers, who are "legitimate" buyers, are assumed to buy more or less uniformly throughout the year.[25] A large part of the grain crop is sold by growers in the fall. And if there were no speculators the natural tendency would be for prices to drop very low at that time.[26] Buyers would be unwilling, furthermore, to buy the grain without taking out a larger margin than they do. But when there are speculators in the market there is a chance to hedge. If prices tend to decline, someone begins to buy as a speculation. Such buying tends to check the decline, and thereby to steady the price, unless the judgment of an effective number of traders indicates that the price is still higher than conditions warrant. If prices go up, those who have been holding to sell at a higher price begin to sell and the rise is checked. If prices go down and speculators truly anticipate an advance, the purchases of speculators tend to increase prices and so to curtail present consumption, thus leaving a larger supply for the future.[27] But if the supply is large the action of speculators in selling or in keeping out of the market forces prices

[25] They do not appear to do so, however, if we may judge from the great variations in their weekly outputs. See James E. Boyle, *The Law of Supply and Demand and the Wheat Market* (1921), p. 34.

[26] It is commonly assumed that grain prices are depressed in the fall, but impartial studies do not entirely bear out that assumption. See, for example, J. E. Pope, "Can the Farmer Realize Higher Prices for His Crops by Holding Them?" *Quarterly Journal of Economics*, Vol. XXX (1916), pp. 805–831.

[27] Another type of speculation arises from watching prices in all markets, and involves the purchase and sale of merchandise in markets which are not "in line." This tends to bring them back into line and so to keep the national and international markets "in line."

down. In this manner consumption is encouraged and a glut in the market at a later time is avoided.

Effect on Prices.—It is often assumed that because grain and other products dealt in on the exchanges change hands many times there results a great deal of duplication of effort and of useless handling.[28] It is further assumed, sometimes, that "everyone takes out a profit." But a consideration of the nature of future trading will show that this assumption is false. There is no direct cost over the brokerage fee, now one-quarter cent per bushel on the Chicago Board of Trade. Many transactions are offset by other transactions and are canceled through the machinery of the exchanges. In such cases the actual transfer of title does not take place. Delivery consists in the delivery of a warehouse receipt. Consequently, physical handling does not occur unless a real manufacturing or trade need causes the removal of the product from warehouse to factory, or from one city to another. Most of the future transactions simply change the ownership of the grain. Furthermore, in regard to the second point, prices cannot be definitely shifted up or down for any period of time as a result of the activities on the exchange. For the factors that ultimately determine the price of the product rest on fundamental conditions of demand and supply outside the exchange itself. The average speculative purchase or sale on the exchange is based on the estimated trend of prices and of itself has no more

[28] The Federal Trade Commission estimates that the average annual volume of future trading in the principal cereals since 1884 has ranged from 16,000,000,000 to 23,600,000,000 bushels. Most of these sales were on the Chicago Board of Trade. In recent years the average crop of wheat, the principal grain sold on future contracts, has ranged from two-thirds to a billion bushels per annum, and the corn crop has been around one billion. In view of the increased size of the crops (the wheat crop was 498,550,000 bushels in 1880 and 1,025,801,000 in 1915), it is evident that future trading is relatively less important than formerly. Thus, for the period 1884–1888 the average annual future sales were 23,600,000,000 bushels; for 1914–1918 they were 19,400,000,000 bushels. See *Report of the Federal Trade Commission on the Grain Trade* (1920), Vol. V, p. 42.

than a temporary effect thereon. If many sales of a given lot of grain occur on a rising market, it is true that each successive seller will make a speculative profit. But if the owner of another lot of grain held it until the peak was reached and then sold, he would reap the full profit which was divided among the several owners of the first lot. The effect in the last case, furthermore, would be to force the price up—since grain was held off the market—whereas the effect of the several successive sales in the former case might check the rise, because many buyers would have purchased at the lower prices. As prices rose, consequently, the buying side would be less important and less prone to become fearful lest they be unable to obtain supplies. And so less pressure would be exerted on the buying side.

The case is made more evident when a falling market is considered. Then each successive seller takes a loss, not a profit. The fact, besides, that there is a constant market for futures enables a holder to sell quickly on a decline and so to shift the risk. This makes it possible to prevent large individual losses.

Evils of Speculation.—No discussion of speculation is complete without mention of the recognized evils which accompany it.[29] In brief, the commonly recognized evils are:

1. Trading by inexperienced persons.
2. Trading with insufficient capital.
3. Manipulation of prices.

(1) Trading by inexperienced persons usually brings unfortunate consequences to them. Their lack of knowledge keeps

[29] The reader is referred to the special treatises mentioned on p. 362 for detailed discussion of these points. It should be remembered that these evils of speculation are true of all speculation. They tend to be minimized on organized exchanges—because rules of the exchange are made to reduce them. On the other hand, some contend that the presence of an exchange leads many people to speculate who would not otherwise do so.

them from forecasting the market properly, and in the end generally leads to heavy losses which they are unable to recoup. But such trading may have an unfortunate effect on the market, as the transactions of the inexperienced "lamb" who does not properly forecast the market may force the price away from the normal trend.

(2) The danger from trading on inadequate capital lies in the loss it may cause innocent traders who have made future contracts with a defaulting party. If, for example, a speculator has sold for future delivery and cannot deliver because prices have risen above his ability to buy, he may cause failure to other persons who had depended on that trade. In many organized exchanges this danger is guarded against by forcing traders to keep a deposit with the exchange, which must be kept large enough to cover any differences between the price at which they have bargained to deliver or to accept futures and the current price of the futures in the market. Individual brokers may also, in the absence of compulsion by the exchange, call on traders whom they represent to protect their transactions by margins.[30]

(3) There are two common means of manipulating a future market. One is to send out false news of market conditions. The other is to carry on operations opposed to the correct trend of the market. By such means it is hoped to stampede the market in the wrong direction so that when the normal forces do begin to function the manipulators can gain a larger profit. For example, by selling, prices may be forced down. If the normal trend is upward, the manipulators may buy at the lower price and hold for the high price which follows. Again, with many persons "short" in the market, i. e., having sold for future delivery goods they have not yet purchased, a large part of the available supply may be "cornered," i. e., held by one person or a small group who will not sell, so that the "shorts"

[30] The various means by which exchanges and individual traders guard against this danger are described in the *Report of the Federal Trade Commission on the Grain Trade,* Vol. V, pp. 155–167, 229–232.

will have to pay a high price to those who control the supply in order to get goods with which to meet their contracts.[31]

The problem of organized speculation is to remove these evils and yet to keep the benefits of the system. The danger of regulation is that in eliminating the evils the benefits will be lost. Much has been done, nevertheless, by exchanges to reduce these evils, and much is being done. Frequent legislative investigations and propaganda against the exchanges have had a salutary effect. Many of the proposals for abolishing or regulating the exchanges are of themselves impractical and undesirable. But they have caused the exchanges to revise their rules, when that is feasible, as well as to bring pressure on individual members to curtail obnoxious practices.

Insurance.—Other risks which are encountered in the marketing of merchandise were mentioned earlier in this chapter. An important means of avoiding many of those risks is through insurance. Insurance does not eliminate risk. It produces an averaging of risks. He who suffers a loss does not bear it in its entirety; a large number coöperate in carrying it. Each pays a proportionate share of the amount which will cover the losses likely to occur in the whole group. Only a few will lose, but those few are protected against excessive loss. Since any one of the group may suffer loss, each is willing to pay into the common fund (the insurance company) to avoid loss in case he should be one of those to suffer. The main effect of insurance is, then, to relieve those insured from a part of the risk burden they otherwise bear alone, a privilege for which they are willing to pay. Insurance is very important to small producers whose activities are not broad enough or large enough to make their risks relatively constant. Thus a retail dealer or a small factory may lose everything through a fire or flood, whereas a great combination with many buildings and plants in scattered parts of a country is not likely to suffer many such losses in any given

[31] This has been rendered practically impossible by the Chicago Board of Trade and by other large grain exchanges, *op. cit.*, pp. 175–182.

time. Its danger of excessive loss is relatively much lighter. Both individual and society would suffer if the small but efficient merchant or manufacturer were left destitute from an unforeseen catastrophe. But through insurance he is saved from such a fate, and may return to his business. Among the risks whch may be insured against are the following: fire, cyclone, death, accident, disease, burglary, violation of trust, and bad debts.

Insurance is of importance to all who are engaged in marketing. It is an important factor in eliminating uncertainty, and so in making the market machinery perform more smoothly and at a reduced cost. This is well illustrated in connection with financing. When a bank makes a loan on combustible merchandise in storage or in transit, it usually insists that the merchandise be insured against loss from fire. Otherwise the risk to the owner of the goods, and hence to the bank which has loaned him money, is too great to warrant a loan. When goods are shipped by water the dangers of loss at sea are provided for by means of marine insurance.[32] By means of insurance, likewise, risk of loss from bad debts, theft, and defalcation may be guarded against. All of this tends to remove uncertainty and so to reduce the ultimate cost of marketing.

Conclusion.—Although some risks can be insured and others can be hedged, there are many business risks which have to be borne by business men (entrepreneurs) which cannot be profitably shifted. In directing industry, the entrepreneur borrows capital, employs labor, and buys materials. He agrees to pay for all of these, whether he is able to sell the resulting product or service at a profit to himself or not. Of course, those who furnish capital, labor, and materials may also lose, but not until the law is satisfied that the business man has paid to the full extent of his ability.[33] Just so long as he is

[32] A marine insurance certificate is one of the documents which, along with the bill of lading, accompanies drafts drawn on foreign customers.

[33] The limited liability features of modern business organizations

able to pay, it is the business man who bears the risks of business. He is willing to bear this risk because the expected profit is a sufficient inducement to counteract the chance of loss. Such risk, consequently, as cannot be eliminated or profitably shifted is borne by entrepreneurs. Even risk which is shifted, unless it is offset by a contract of an opposing character, such as the hedge, must be borne by the one to whom it is shifted. In the end all the losses which result from market risks must be borne by some one. But by the means which have been discussed many of these risks are removed or minimized and still others are divided.

modify this to a degree, so far as individual members of a corporation are concerned.

CHAPTER XVIII

MARKET NEWS

I

The significance of adequate market news and of the standardization of products in effective marketing has been suggested from time to time in previous chapters. This and the following chapter include a more thorough consideration of these points. The two subjects are closely related. Each is important in the establishment of market price and in increasing the ease with which the transfer of title can be accomplished. The full usefulness of neither, moreover, is possible without a proper development of the other.

Importance of Market News.—Market news is a pervasive element in marketing. It is the determining factor in establishing market price.[1] If the collection, interpretation, and circulation of market news could be so perfected as to make absolutely accurate prevision possible, market risk would disappear.[2] By minimizing risk, market news makes the problems involved in market finance less difficult of solution; loans can be given and credit extended on sales with greater certainty of normal payments being made, and investment in stocks and in sales campaigns is likewise attended with less risk.

It is assumed by the apologist for the competitive régime that the forces of demand and supply tend constantly toward an equilibrium. But as markets grow in size and complexity, as roundabout methods of production involving months and

[1] See Chap. XXI.
[2] See pp. 356–357.

years of time are more extensively employed, and as the necessary investment in fixed plant increases in relative amount, conditions arise which make it necessary that information concerning demand and supply be carefully collected, interpreted, and dispersed, if this equilibrium is to be in any measure realized. It is the presence of these conditions in modern industry, together with the lack of sufficient market information, that is a frequent cause for individual failure on the part of business men, just as it is a common cause of alternating high and low prices for individual commodities.

Problems Arising from Inadequate News.—An adequate market news service prevents much waste in marketing, waste which is of great importance to the common welfare as well as to those most directly concerned in individual transactions. The most obvious waste from inadequate market news is found in the market for perishable foods, more especially fruits and vegetables. These products are grown by numerous producers, frequently scattered over a large territory, and in widely separated producing areas. If too great a supply reaches a given market, prices will drop, and it may not even pay to market some of it. At best a low price will prevail, and the goods must be sold at this price or shipped on to other markets. This is impossible with the more highly perishable commodities, and great deterioration occurs with many others. The roundabout shipment and sale also cause additional costs to be incurred. And when prices are forced down in the one market, consumers depending on other markets where the surplus might have gone, may be forced to pay high prices because the supply there is small.[3]

Again, knowledge of the nature of even the more stable conditions of demand for perishables is often lacking. Some consuming markets favor white eggs and brown eggs must be sold at a discount. Other markets have the opposite preference. Green asparagus is demanded at some points, white in others. The baskets, crates, and other containers in favor in

[3] This has an important effect on prices and risk. See pp. 57–58.

markets also vary, and a product packaged for one market must sometimes be repackaged or sold at a discount in others.[4]

Market News and Business Policies.—In all industries a knowledge, or a forecast, of future market conditions, as well as of day to day developments, is important. All production is for the future; and, consequently, producers establish production policies on their judgment of future markets; merchants determine purchase policies on their judgment of future markets; and traders on speculative exchanges, likewise, base their transactions on forecasts of the market. The more elastic the demand for a product the greater is the need for a proper estimate, for production must usually begin long before sales are possible, and large stocks must often be accumulated before the market forces are definitely in operation.

The Market Forecast.—A proper forecast of the market for either the immediate or the distant future is dependent in the first instance upon a full knowledge of the pertinent conditions which bear on demand and supply, and on the timeliness with which these facts are ascertained. Then, with the data at hand, the accuracy of the forecast depends upon the skill with which they are interpreted.

Both the volume of products which may reach the market and the intensity of demand become more and more uncertain as forecasts extend further and further into the future. The activities of other producers, changes in technique, weather conditions, general and special business conditions, the reaction of consumers to products and prices—these and many other conditions are variable. They are difficult to determine for the immediate future; and as the time for which they are to be forecasted increases, the difficulty of prediction grows greater.

The speed with which the knowledge of conditions is disseminated to interested parties varies greatly. This is ex-

[4] See G. K. Holmes, "Consumers' Fancies," U. S. Department of Agriculture, *Year Book,* 1904.

tremely important, for those who first possess knowledge of significant conditions thereby gain great advantages.[5] It is on account of the importance of the time element that large business concerns, especially those operating in speculative future markets, often have elaborate agencies for gathering market news, as, for example, leased telegraph wires with which to obtain and distribute the news quickly, and secretly.[6] In contrast with these are the smaller operators, farmers, manufacturers, merchants, and the final consumer, most of whom are almost entirely dependent on outside, and often prejudiced, sources of information.

Interpretation of Market News.—The value of market news depends, finally, not only on the accuracy and completeness with which it is gathered and the speed with which it is disseminated, but also upon the skill with which it is interpreted. No matter how much information is available it is valueless until interpreted; and upon the skill with which he interprets the data at hand depends in large degree the business success of the trader and even of the producer. For

[5] "Of market news, time is the essence. For, in the bargaining process superior knowledge may be secured in two ways; it may be a broader, sounder, more comprehensive knowledge, or it may be an earlier knowledge. As a market becomes more and more thoroughly organized, competition in knowledge tends to be narrowed to securing an earlier knowledge. A marvelously efficient organization has been developed as a result of this sort of rivalry, and has concentrated itself in the organized exchanges. As has been shown already, the activity most frequently associated with organized exchanges is dealing in 'futures,' and to deal intelligently there must be a broad and sound basis of knowledge. The very sensitiveness of exchange prices is due to their immediate response to market news. . . .

"Knowledge of facts, then, that can be judged on a price basis is market information."—C. S. Duncan, *Marketing: Its Problems and Methods* (1920), pp. 206–207.

[6] One member of the Chicago Board of Trade has 23,239 miles of leased lines in its private wire system. See *Report of the Federal Trade Commission on the Grain Trade,* Vol. V, p. 111. Forty-eight other members operated private wires in 1919.—James E. Boyle, *Speculation and the Chicago Board of Trade,* pp. 17, 217–218.

from that interpretation business policies are determined and plans are formulated. Here, wide variations are found among business men. Many depend on rumors and "hunches." But some spend large sums in gathering news and putting it in form so that the executives can most readily and accurately interpret it.[7] Successful speculation, in particular, depends upon prompt and accurate collection and interpretation of market news. But to all business timely news which is quickly and accurately interpreted is essential.

II

Sources of Market News.—Our National Government offers what is by far the largest single source of market information in this country, through the (1) annual and special reports of its many bureaus and departments.[8] Yet another important source of information is the (2) data compiled by business men in their own offices: from material obtained by governmental bodies and other agencies, from the records of the business, and from the experiences of their own staff. Furthermore, special investigations for the purpose of securing information not otherwise available, are (3) now made for business houses by their own staffs or by outside agencies. Somewhat similar to this is the information collected by trade associations from their members. Large banks, likewise, have departments for gathering and interpreting market news which will be of assistance to their officers and clients. Finally, there are private agencies, such as the market reporters of the agricultural markets, representatives of the public press, research departments of educational institutions, and private research and statistical agencies.

[7] See Horace Secrist, *Statistics in Business* (1920); L. D. H. Weld, "A Strong Foundation for Your Advertising," *Printers' Ink*, Jan. 9, 1919, pp. 3–12; C. S. Duncan, *Commercial Research* (1919); J. G. Frederick, *Business Research and Statistics* (1920); and Percival White, *Market Analysis* (1921).

[8] See W. I. Swanson, *Guide to U. S. Government Publications*, Bulletin No. 2, U. S. Bureau of Education (1918).

Dissemination of Market News.—The most familiar medium for the dissemination of market news is the public press. The advertising pages of magazines and newspapers are utilized entirely in giving such information, especially that concerning the supply of specific products and services. Newspapers and trade journals quote the prevailing prices for raw materials and foods—live stock, grain, wool, vegetables, and fruits—for many manufactured products, and for stocks and bonds. News articles give general information of market conditions, and of political, legal, social, and economic considerations bearing thereon. In addition to the newspapers and magazines, some of which are known as "business periodicals," there are over 3,500 trade and agricultural papers in the United States, the chief purpose of which is to gather and circulate market news. The annual and special reports of produce exchanges, chambers of commerce, and trade associations[9] also contain valuable market news.

The mails, the telegraph, and telephone are also used extensively. The sources just mentioned are mainly dependent upon these for collecting and communicating the news which they interpret and circulate. By means of these the news bureaus and telegraph companies, private market reporting agencies, and private wire houses[10] send out data on opening and closing prices on produce exchanges and on stock exchanges; and quotations are sent out daily by commission merchants and wholesale receivers to the country shippers of grain and other produce. Goods are ordered by mail, telegraph, and telephone, and quotations are made by the same means. Private information from salesmen and agents is received through these mediums, and general market information is also sent over the wires and by mail.

Finally, as important a source as any to many business men is market news conveyed by word of mouth—conversation with salesmen and buyers, advice secured from bankers

[9] See the discussion of open price associations, pp. 389–390.

[10] See James E. Boyle, *op. cit.*, pp. 17, 217.

and private research and statistical agencies, talks with business associates, friends, and acquaintances.

News of the Agricultural Market.—In view of its importance and the difficulties involved in its collection perhaps the most complete and accessible information is available concerning the domestic agricultural market. Especially valuable is the work of the Bureau of Markets and Crop Estimates of the United States Department of Agriculture and of the Bureau of the Census of the Department of Commerce.

The purpose of the market reports of the Bureau of Markets and Crop Estimates is "to cover the markets upon every farm commodity which constitutes an important part of the Nation's food and clothing supplies . . . for the express benefit of producers, distributers and consumers."[11] This service has to do principally with current market news—prevailing prices in different markets, amounts shipped from various producing areas to specific markets, current production and available stocks. The crop reports, on the other hand, are primarily important as a means of estimating future conditions of supply—acres planted and the condition of the crops at various times during the growing season.[12] For the year 1921-22 the appropriation for the market news service of this bureau is $601,560. It is proposed to spend this sum according to the following allotments: [13]

Leased wires	$ 67,000
News service on live stock and meats	160,240
News service on fruits and vegetables	248,680
News service on dairy products	68,300
News service on hay, feed and seed	27,780
Transportation service	9,500
Market information (general)	14,860
Bureau administration	5,200
	$601,560

[11] W. A. Wheeler and Frank George, *Know Your Markets* (Separate No. 834, from the U. S. Department of Agriculture, *Yearbook,* 1920, p. 146).

[12] The Bureau of the Census covers this work for the cotton crop.

[13] From a letter from the Bureau.

"The Bureau of Markets has in the United States 73 branch offices located at 46 large market centers, 16 of which are directly connected with the Washington office and with each other by some 4,500 miles of leased telegraph wires. Marketing experts keep in constant touch with market conditions in the field and at consuming centers and at least 15,000 responsible individuals, firms, and railroads—voluntary reporters—render reports to the bureau regularly upon the marketing of farm products. Mimeographed reports are still sent to producers and the trade direct, but by the use of the telegraph and the press and latterly of the wireless these and the other reports sent out by the Bureau of Markets are received by not less than 15,000,000 potential readers." [14]

Other important sources of market information for agricultural products are the daily quotations sent out by telegraph of transactions on produce exchanges, the numerous market reporters [15] and trade journals of local, sectional, and national circulation, the daily papers, the annual reports of produce exchanges, and the reports of the International Institute of Agriculture at Rome.[16]

News of Manufacturers' Markets.—There are as yet no governmental bodies in the United States engaged in gathering market news of manufactured products on anything like the scale on which news of the agricultural market is collected. The work of the Bureau of Foreign and Domestic Commerce in the field of foreign trade will be touched upon later. The Federal Trade Commission is making constant

[14] W. A. Wheeler and Frank George, *op. cit.*, pp. 131–132.

[15] The largest private news agency of the grain trade is Broomhall's. It has representatives throughout the world. The news which it gathers is cleared through the headquarters at Liverpool. See Bruce D. Mudgett, "Current Sources of Information in Produce Markets," *The Annals of the American Academy of Political and Social Science*, Vol. XXXVIII (1911), p. 433. In the produce trade the Urner-Barry Company of New York is perhaps the best known. See L. D. H. Weld, *The Marketing of Farm Products*, pp. 301–304, and the *Report of the Federal Trade Commission on the Wholesale Marketing of Food* (1920), pp. 227–228.

[16] An interesting discussion of the sources of price information available to country elevators will be found in the *Report of the Federal Trade Commission on the Grain Trade* (1920), Vol. I, pp. 175–187.

contributions, and more recently certain bureaus in the Department of Commerce have devoted considerable attention to domestic conditions in the market for manufactured commodities. A start has been made in the *Monthly Survey of Current Business* conducted by the Bureau of the Census, the Bureau of Foreign and Domestic Commerce, and the Bureau of Standards of this Department. The first number was issued in August, 1921. This gives summarized comparative figures of stocks, production, and prices for important commodities, of foreign trade conditions, transportation, retail trade, banking and finance, interest rates, earnings and employment, the cost of living, and other subjects.[17] The Decennial Census reports and the Census of Manufactures, many of the publications of the Bureau of Standards, and the information contained in the *Monthly Review* of the Bureau of Labor Statistics of the Department of Labor, also contain valuable information.[18]

Trade Associations and Trade Papers.—Another important source of information concerning manufactured lines is the work of trade associations and trade papers in gathering and distributing news of trade tendencies, prices, supplies, and demand. It has been estimated that there are several thousand trade associations in the United States securing and circulating market news in one way and another. These associations may be particularly serviceable in industries in

[17] "The general idea is to establish monthly some composite picture of our industries in such form that it will be of practical service in guiding business men in general business situations.

"At the present time [Nov., 1921] . . . the Bureau of Census is acting as a center point for the clearing of statistics from some twenty-five or thirty trade associations as well as from the records of the Bureau of Census, all other Government departments and private and semi-private statistical organizations."—Extracts from a letter from the Department of Commerce.

[18] Other governmental bureaus which collect and disperse important market news are the Weather Bureau, the U. S. Geological Survey (minerals), and the Bureau of Forestry.

which there are many competing firms, all relatively small. For only by coöperative action, or by governmental assistance, can the facts be obtained and the expense of collecting, interpreting, and publishing them be borne.

Open Price Associations.—An interesting development of trade association activities is the "open price association." Under this plan members of the association submit to each other, or more often to the secretary of the association, the prices which they have received for goods sold, or the prices which they have submitted as bids on proposed sales. This information is then sent to the members of the association. The purpose is to give them immediate knowledge of what has transpired in the market.[19] But these associations have sometimes gone further. The secretaries have "interpreted" the data, and suggestions concerning the future trend of prices have been issued. In other cases definite price agreements have been entered into.

The legal status of the open price association has been uncertain, but recent court decisions seem to show that (1) so long as they merely gather and disperse news of what has already happened they are legal.[20] (2) But when they go further and the reports are "interpreted" by the secretary, who recommends harmony of action, it is illegal under the Sherman Act.[21] Since a case involving the first principle

[19] See H. R. Tosdal, "Open Price Associations," *The American Economic Review,* Vol. VII (June, 1917), pp. 331–352; Arthur J. Eddy, *The New Competition* (1912); Emmett H. Naylor, *Trade Associations* (1921), Chaps. VIII, X, XIII, XV–XVIII.

[20] Judge Carpenter of the Federal District Court in the case of the United States vs. the Armstrong Bureau of Related Industries (Dec. 3, 1921), made a comparison between the operations of an exchange in issuing price quotations (which has been held legal) and the acts of this association. "An exchange sends out reports of actual sales. The Armstrong Bureau gave out price-lists. It is difficult to understand any ground for declaring one legal and the other illegal."—From a newspaper report of the decision.

[21] See the decision of the Supreme Court in the case of the United States vs. The American Hardwood Lumber Manufacturers' Association

has not yet come before the Supreme Court, a question still exists as to where the line between the legal and illegal acts will finally be drawn. In the "Hardwood Lumber Case" the Supreme Court drew a distinction which Judge Carpenter did not draw in the "Linseed Oil Case" [22] to the effect that market news distributed by government publications and by exchanges goes to both buyer and seller, whereas the reports of the association go only to the members. But the Court made this as one point and made a separate point of the fact that there was no skilled interpreter of the prices in the case of government publications and exchange quotations whose interpretation might lead to uniform action among "competitors," whereas there was in the case of the lumber association. It is not clear, consequently, whether the fact that the information goes to members alone, in the absence of "interpretation," would be considered legal or illegal.

Important Sources of Foreign Trade News.—The most important statistics of foreign trade are those gathered by the Bureau of Foreign and Domestic Commerce of the Department of Commerce, and published in the *Monthly Summary of Commerce and Finance*, in the *Weekly Commerce Reports*, and in special reports issued from the Bureau. These reports, which are obtained from other governmental departments, as well as by the staff of the Bureau, give comparative figures covering the value, and often the quantity, of imports and exports for each month of the current year, for the corresponding month of the past year, and for preceding years. A complete report of the exports and imports of specific products is included in the annual report *Commerce and Navigation*. This Bureau also issues a weekly paper, *Weekly Commerce Reports*, covering conditions existing in various foreign countries and even giving specific market

(Dec. 19, 1921). This case and the legal status of open price associations are discussed by E. H. Naylor in an article, "The Hardwood Lumber Case," in *Administration*, Vol. 3 (April, 1922), pp. 487–493.

[22] See note 20, p. 389.

opportunities. Special pamphlets are published on market conditions in the sale of particular products and on trade conditions in particular parts of the world. Finally, confidential information of specific trade opportunities is given to accredited manufacturers.

Much of the information which the Bureau of Foreign and Domestic Commerce publishes is received through reports from the members of the consular service, which is attached to the Department of State. There are some 300 United States consular offices throughout the world, one of the main functions of which is to keep in touch with commercial opportunities and business conditions, and to collect information that will be helpful to American business men. The results of their efforts are made available largely through the Bureau.

Some of the large banks and such institutions as the Philadelphia Commercial Museum also gather news of general and specific foreign trade opportunities, and in some cases make special investigations for their clients. Information concerning foreign tariffs can be procured through such private agencies as those mentioned, as well as through the Bureau of Foreign Trade Advisers of the Department of State, the Tariff Commission, the Pan-American Union, and the Bureau of Foreign and Domestic Commerce.

News of General Commodities.—Valuable sources of information about prices of general commodities are the monthly and special reports of the Bureau of Labor Statistics of the Department of Labor. This information is published in the *Monthly Labor Review* and in special reports on wholesale and retail prices. The statistical tables which are included cover prices for the current year as well as for several years past. Unfortunately, these data are usually published some time after the facts are gathered, although such parts as have a news value for periodicals are given out in advance of the regular publication. The new *Survey of Current Business* issued by the Department of Commerce also bids fair to be of great value in circulating news of this kind.

General Market Conditions.—Finally, all business men are interested in what may be called general market news, that is, news which indicates the general conditions which prevail throughout the country and the world—looked at not as a particular market, but as a great complexity of markets. There are certain general sources or "indices" to which business men commonly look.[23] These relate to the conditions that exist in such markets as the following: (1) general business—including building and real estate, iron production, bank clearings, business failures, labor conditions, immigration, crop conditions; (2) financial conditions—including conditions in the money market, foreign trade, gold movements, commodity prices; (3) the investment market—including prices of securities, crop statistics, railroad earnings, and social conditions. Conditions in the steel market are also considered of particular importance in determining the general conditions of industry. Some of these markets are of particular interest to certain groups of business men, some to others. Thus, the first group of markets is believed to show the trend of the general business situation, the second group applies to the money market, and the last group to the investment market. Some statistics, such as stock market prices, banking and building statistics, are used to forecast future conditions; whereas others, such as imports of merchandise, commodity prices, or business failures, are better used to indicate the existing situation, although future tendencies may also be indicated by them.

III

Control of Market News.—Since the activities of producers and traders, and even those of consumers, are guided by their

[23] See R. W. Babson, "Barometric Indices of the Conditions of Trade," *Annals of the American Academy*, Vol. XXXV (1910), pp. 593 ff; also M. T. Copeland, *Business Statistics* (1917), pp. 98–131, and Vol. I of the publications of the Harvard University Committee on Economic Research.

knowledge of the market, it is important that news should be accurate and timely. Prices, otherwise, will not reflect true conditions, and great harm may result to the public, as well as to private traders and producers. The statement that the crops in a particular section are abnormally large or small will commonly have an immediate effect on prices. If the statement is false, prices will be out of line with actual conditions. This will cause unwarranted loss to some and gain to others. Here is a great opportunity for private individuals, by spreading false news, to reap large gains at the expense of others. It is, consequently, important that the information which is dispersed shall be accurate. In "future" markets where even a rumor may cause changes in prices amounting to thousands, or even millions of dollars in the aggregate, it is particularly important that the dissemination of market news be carefully guarded. On the Chicago Board of Trade in order to safeguard the news a very strict control is exercised by the Market Reports Committee over all news issued by members of the Board, and by any others who receive their information through it, i. e., over all individuals and firms over whom it can exercise control. This includes the reports of private wire houses, the private reporting agencies, members' daily market letters, and the reports of telegraph and news ticker companies. The market letters of members are not allowed to forecast the market or to give advice. Market rumors are forbidden.[24]

Large firms can usually afford the expense involved in gathering market news, and those who control a large part of the trade in any particular commodity have through their own records the means of determining market conditions with a fair degree of accuracy. But smaller firms have no such facilities. To meet their needs either associative activity or governmental action is necessary. In this country the former

[24] See the rules of the Board of Trade; also the *Report of the Federal Trade Commission on the Grain Trade,* Vol. V, pp. 68–79, and J. E. Boyle, *op. cit.,* pp. 96–97.

has been rapidly developing among dealers and producers of manufactured products and raw materials other than farm products. And thus far governmental activity has been more concerned with farm products. At present there is a movement toward governmental assistance in gathering news of the manufacturers' market. And in the farm market such large organizations as the California Fruit Growers' Exchange and the new United States Grain Growers Incorporated collect information for themselves.

News Collected and Dispersed by the Government and by Associations.—News gathered by the government and by trade associations is not always so timely as that obtained by large individual firms, so that these are often in possession of essential facts some time before those who depend on the government, trade associations, or other outside agencies. On the other hand, the news gathered by governments and by trade associations is likely to be much more extensive and accurate. This is partly due to the greater resources which may be made available to cover the expense involved, and, sometimes, to the greater spirit of coöperation which is likely to prevail among those with facts to contribute. Finally, the government may, if the public welfare demands, insist on receiving pertinent news.[25]

Wherever there are many small business men engaged in an industry it is essential that some neutral and impartial agency should gather and disperse market news. Private information when collected is commonly only for the limited use of those who gather it, and when published it may be colored by the point of view of the compiling firm. Apparently the great number of both producers and dealers who

[25] The efforts of the Federal Trade Commission to compel business firms to file reports on forms presented by the Commission—a power given by section 6 of the Federal Trade Commission Act—has been halted by temporary injunction in the case of the coal and steel industries. See *Annual Report of the Federal Trade Commission* (1920), pp. 48–52; *ibid.* (1921), pp. 54–56.

are working on a relatively small scale can receive adequate market information only through some governmental agency or through coöperation on a very large scale.[26]

Conclusion.—It may be said, finally, that if the market news were complete, accurate, correctly interpreted, and thoroughly disseminated, demand and supply, in the absence of unforeseen natural conditions or artificial restrictions—such as patents and monopolies, governmental or private—would always balance; and business profits, as a reward for risk-bearing, would be entirely absent. But these conditions are far from realized; and, consequently, producers and dealers face the possibility of gain or loss, high prices or low, according as they are so fortunate or so keen as to possess articles for which the demand is great, or so unfortunate as to possess those for which the demand is small. (In the modern market business success depends very largely on the ability of the individual business man to forecast his market properly.)

[26] Duncan believes that market news is so important that its collection will ultimately be considered in the light of a public utility. See C. S. Duncan, *Marketing: Its Problems and Methods* (1920), p. 219.

CHAPTER XIX

STANDARDIZATION

Some of the most important problems involved in marketing center about the preparation of products for market. The most important of these is the endeavor to divide merchandise into groups with such common characteristics as have proved to be important in exchange—that is, to standardize them on the basis of quality and size. Closely related to this are the adoption of standard units of measure and of price quotations, and the adoption of standard containers. The purpose of standardization, in so far as it affects marketing, is to prepare goods so that they will best meet the demands of the market, and so that a common standardized nomenclature can be utilized in bringing about an understanding between buyer and seller.[1] The standardization of commodities may be a production activity, or it may be a market activity. But the possibility of standardizing arises from the fact that the products involved have common characteristics. That is, it is determined by the results of production.

Standardization Makes Exchange Easier.—Products which are standardized as to all characteristics considered important

[1] Most of the discussions on marketing have emphasized grading. But the important thing is the standard. Grading is simply a means of dividing products of varying quality and size into lots conforming to certain standards, or it is a means for determining to what standard goods of similar, but as yet unknown, qualities conform. When goods, as produced, are not standardized or when the standard to which they conform is unknown, grading or classification is necessary. But when the production can be sufficiently controlled, grading is unnecessary. See also H. B. Vanderblue, "The Functional Approach to the Study of Marketing," *Journal of Political Economy,* Vol. XXIX (October, 1921), pp. 676–683.

by the buyer can be sold on the basis of sample, grade, description, and symbol.[2] Purchase and sale are thereby greatly simplified. With quantity, size, and quality (material characteristics and performance in use) standardized, price is the only indeterminate factor.

Standards likewise make sale by inspection and sample easier. This is the case because fewer samples need be taken and because these samples conform more closely to the bulk than do samples of unstandardized goods. Consumers tend to insist, furthermore, upon purchasing a standardized product. Because their particular purpose demands a standard product, or because they find it easier to purchase them, buyers will often pay a premium for standardized goods. On account of this premium it pays the seller to standardize when the cost is not too great. The premiums which Washington apples receive over the ungraded product of eastern states, the premium paid for graded wool and the low price at which a "farmer's car" of ungraded potatoes is sold are all cases in point.[3]

Another advantage from standardization is that lots made at different times or by different producers may be mixed together, if all essential characteristics are the same. Orders for future delivery can also be given on the basis of predetermined standards. Financing is likewise rendered less difficult, because the value of uniform lots is more readily determined and because sale can be made with greater ease and on shorter notice than is the case with unstandardized goods. Fluctuations in prices can be more certainly followed and more quickly known. Risk is thus lessened, and so financing is rendered safer and cheaper. The product comes nearer to "financing itself," since it can be more readily used as col-

[2] See pp. 23–27; also H. B. Vanderblue, "The Marketing Function of Advertising," *Advertising and Selling* (June 5, 1920), pp. 16–18.

[3] "Compared with the cost of its performance there is none of the marketing functions which enhances the value of commodities as greatly as this one of grading."—P. T. Cherington, *Elements of Marketing* (1920), p. 74.

lateral security for the loans made to move it to the market. Finally, when standards are known and accepted throughout a large market area, market news of supply, demand, and price reaches its maximum of accuracy and hence its maximum value.[4]

Standardization Aids Physical Supply.—Standardization likewise decreases the difficulties and the costs involved in the transportation and storage of products. Useless parts can be eliminated from a given bulk, leaving only those units which conform to the standards set for the particular purpose to which the product is to be put. Each grade, furthermore, of a standardized product can go more directly to its final place of use. For example, when agricultural products are graded at the producing market it becomes unnecessary, provided the standards are recognized in the trade and the purchasers have faith in the honesty of the grading, to concentrate these products in the warehouses of central market middlemen simply for the purpose of grading.

Bases for Standards.—The basis upon which a standard rests may be (1) a quantity basis, such as those standards of weights and measures, which have been established by the governments of the civilized world; (2) it may be a numerical basis, such as the dozen, gross, ream, etc.; (3) it may be a basis of size and measurement, as with screws, bolts, lumber, shoes, clothing, rugs, and thread; (4) it may be a quality basis—positive quality, as in the case of grain and cotton standards, and chemical contents; negative qualities, as with the pure food and drug laws;[5] (5) it may be a service basis. Service is obviously least amenable to standardization. The average merchandising establishment, retail store or whole-

[4] The relation of standards to farm markets is well developed in L. D. H. Weld, *The Marketing of Farm Products,* pp. 362–364. See also H. Bruce Price, "Grain Standardization," in the *American Economic Review,* Vol. XI (June, 1921), pp. 227–230.

[5] See C. A. Adams, "Industrial Standardization," *Annals of the American Academy of Political and Social Science,* Vol. LXXXII (March, 1919), p. 290.

sale house is nevertheless fundamentally engaged in the sale of service. It is the desire of such firms to establish in the minds of the public which they serve the idea that they are rendering a high standard of service. The service of transportation companies likewise tends to become standardized.[6] The manufacturer, too, frequently tries to convey an impression to the minds of prospects and customers of the high standard of products and service which his house sells. For example, house brands are used in the sale of a "family" of products for the purpose of attaching the reputation of the house to the particular products which bear the brand, i. e., the manufacturer tries to assist the sale of all of his products by impressing upon the minds of consumers, through the house brand, the idea that the standard quality and service which the house stands for is behind every product on which the brand appears. Finally, (6) price may be standardized. The "one price policy" which prevails so largely in our retail stores, and which is coming to be common in the sale of many manufactured products at wholesale, is after all a standardized price; i. e., so far as purchasers are concerned the price is standardized. Each buyer does not need to bargain in order to be sure that he is getting as low a price as other buyers. Public utility rates, likewise, are examples of standardized price.

Standards May Rest on Several Bases.—A standard need not rest on but one basis; it may involve several. Coins, for example, are standardized as to quality and weight; grain is standardized as to weight, moisture content, quality, and color. The standards set may be generally recognized in a given trade, to which all producers conform, and to which all products are compared; such are wheat and cotton grades, thermal units with coal, metal content with steel rails, thread count and quality of thread with cloth. They may be standards set by individual producers which are not directly comparable

[6] The uniform bill of lading, uniform warehouse receipts and service, and the banker's acceptance are also examples of important market standards, and so are the meaning of price quotations—such as f.o.b., c.i.f., etc.—when they become uniform.

to competing products. Such standards are usually represented by trade names and brands. Finally, the standards may be specifications set by buyers or sellers, such as cotton merchants' samples, specifications for machines, and the like. Generally recognized standards are common with production goods, and particularly with raw materials. Individual standards are usual with goods for personal consumption and with equipment.

Responsibility for the Observance of Standards.—It is evident that to realize the greatest advantages from standardization the standards must conform to recognized demands of the market and, of fundamental importance, there must be faith on the part of the buyer and seller in the standards established. This faith may rest upon the fact that an efficient and disinterested official has examined the products and has declared that they conform to a particular standard. The grading of grain by the inspection departments of produce exchanges, and more especially by government officials, is one of the best examples. Other examples of governmental standards are found in the standard container acts, the regulation of weights and measures, the establishment of grain and fruit grades, and of official cotton grades. Such work is carried on by the state and Federal governments. Some of the most important market activities of the Federal Government are those connected with the enforcement of the grain standards act and similar acts, the standard barrel act, and the work of the Bureau of Markets and Crop Estimates, the Bureau of Standards, and the administration of the pure food laws.

In other cases this faith in established standards must arise out of belief in the honesty of the seller who declares the product to be of a certain quality. Confidence of this kind is evidenced in the sale of branded products, such as California fruits and many manufactured products. The precise elements which are standard may be uncertain; but if the product meets one's need, and if he has faith that further purchases of this brand will be up to the standards

of the past, he can buy the product with assurance that it will continue to give the same degree of satisfaction, so long as his personal reaction remains the same. Even in the absence of such faith advantages result from the standardization of products. For the product is easier to inspect, even though lack of faith in the standard makes it undesirable to purchase by description or symbol.

Standards and the Buyer.—Standards are commonly set to accord with the needs of buyers.[7] This is especially true of production goods—materials to be processed.[8] Standards set with the buyer in mind are also important in the case of goods sold for personal consumption. This is due fundamentally to the fact that consumers buy those goods which they have found to suit their needs best. Standardization assumes particular importance when goods are advertised and sold by trade-mark, trade name, or other symbol. These devices attached to a standard product enable the satisfied consumer to buy the same product again, without the need for further experimentation. If the goods do not meet his fancy, it is likewise easy for him to avoid them in the future.

Mass Selling Methods Call for Standardization.—Standardization is likewise important to sellers. This is particularly true of those who utilize mass methods of selling. The use of advertising, for example, in most of its manifestations is dependent upon mass appeals. Mass methods are likewise characteristic of the modern use of salesmen. Because of the large expenditure involved in the use of advertising and personal salesmen, they can be used most economically in the

[7] This is said not to be true of many farm products, especially fruits and vegetables. Laws in fourteen states fixing standards for barrelled apples and six for boxed apples show that these standards were set according to production conditions and not to the needs of buyers. For this reason it has been impossible to fix national standards for these products. (Letter from the U. S. Bureau of Markets and Crop Estimates.)

[8] The importance of this phase of standardization was discussed in Chap. VI.

sale of a large volume of similar products. This is especially true when the unit value is not great. To put it in another way, modern large scale methods of selling, both advertising and the use of salesmen, are too expensive to use, unless they can be employed to sell standardized products.

The Container and Standards.—An important adjunct to the sale of goods standardized by the producer and known to the trade by his name or trade symbol ~~is the container~~. In this connection the container commonly serves three important purposes: (1) it prevents physical deterioration; (2) it prevents substitution or adulteration of the contents; (3) it serves as a means of carrying marks of identification which aid the consumer in purchasing the product. The identification, furthermore, helps to prevent the substitution of competing goods by supply houses. These uses of the container are particularly important with goods which cannot be made to carry any identifying mark, such as sugar, flour, and liquids. The use of standard containers which are recognized over a wide area makes it possible to place goods in packages as soon as they are ready for market, since they need not be changed to other containers in case they do not go to the market to which they were first expected to be sent. A standard container also standardizes the quantity element in a transaction, since buyers can know, without trial, what quantity a given standard container holds.

Methods of Standardization.—Some products are easily standardized. This is true of most products fashioned by machines—screws, bolts, cloth. Goods of this character are standardized as they come from the machine. Some goods have to be assorted in order to be standardized. This is particularly true of farm products, in which there are sometimes great variations in quality and size. And in order to obtain the benefits of standardization, standards—commonly called grades—have to be established and the goods assorted into lots which conform to these standards. Fruits and vegetables and wool are standardized in this way. In the sale of grains the stand-

ards set are also known as grades. Grains, however, are not conveniently sorted so as to conform to these grades. But since the grain from a single grower or even a particular territory tends to be uniform, sorting is not essential. Quantities in bulk are sampled and the grade of the bulk is determined by inspecting the sample to see to what standard (grade) it conforms.

Advertising and Branding Standardized Goods.—Advertising and branding are important means of selling the standardized products of individual producers.[9] Advertising, or other selling effort, tends to establish in the minds of prospective customers an idea of character and quality. The customer on finding an article that satisfies is enabled to purchase it again, because it has been branded for that very purpose. Branding, consequently, eventually renders the purchase of the ordinary articles of every day consumption relatively easy for the average consumer. True, a great many competing producers are endeavoring to get him to try their product, but in proportion to the great bulk of his purchases changes are few. It has been shown that modern methods of selling would be very costly and often unsuccessful were the products sold not standardized.[10] On the other hand, the economies of large scale standardized production would be impossible were no large market created by the sales force and advertising, and were it not for the additional fact that the good will thus created inheres in the brand and so renders repeat orders less costly to obtain.

Not All Standardized Goods Sold by Description.—The fact that a product has been divided into groups and classified as conforming to certain standards does not mean that sale by

[9] They may also be used in the sale of agricultural specialties by growers' associations—as the California citrus fruit, walnut, and raisin growers, New England cranberry growers—or of classes of manufactured products, such as cement and lumber, in the creation of a demand for which competing manufacturers coöperate.

[10] See P. T. Cherington, *The Elements of Marketing* (1920), Chap. XIV, and H. B. Vanderblue, "The Marketing Function of Advertising," *Advertising and Selling,* June 5, 1920, pp. 16–18.

description thereby becomes possible. Raw materials cannot, as a rule, be so closely standardized as to make this possible. Variations in the natural conditions—soil, moisture, climate—which affect quality and size are too great, and within very wide limits are beyond human control. This is particularly true of farm products.[11] Thus, when wheat is purchased by mills, samples are very closely examined to determine whether the grain is exactly suited to the purpose in hand. There is usually a slight difference in the price paid in the spot market for different lots of grain of the same grade. It is only in the "future" market, i. e., in speculation and hedging, that sales of farm products by description prevail. With manufactured products, on the other hand, much more use of sale by description is often possible. Faith in the integrity of the selling party being assumed, the extent to which sale by description can be made depends upon the extent to which the standards conform to the needs of the purchaser, and on the extent to which the goods conform to the standards set. This conformity is usually much more exact with manufactured products than with those of the farm, forest, and mine.

The Need for Standards.—The extension of universally accepted standards of quality should go far to make marketing more efficient and less costly. Quality is the unknown factor in most mercantile transactions. It must be determined before sale occurs. Standard weights and measures eliminate the difficulties involved in knowing what quantities are exchanged. Buyer and seller can thus come to an immediate agreement on that score; and in case of dispute recourse can be had to an impartial judge in the standard scale or standard measure.[12] The medium of exchange, i. e., price-measure, is

[11] Nevertheless, the growing knowledge on the part of farmers of the importance of raising commodities which meet the market needs is bringing a far greater degree of standardization than formerly existed, and has tended to improve greatly the general quality of the goods produced.

[12] These are not completely standardized in the United States. There are, for instance, forty-three legal bushels by weight (the Winchester

also standardized, so that both buyer and seller know definitely what the terms of sale are to be when a price is agreed upon. But the common lack of standards of quality makes necessary a process of bargaining between buyer and seller which is cumbersome and expensive.

With consumption goods, and particularly with those which are manufactured, this expense is largely borne by the seller —manufacturer or middleman—who endeavors through advertising, salesmanship, and other selling devices to convince the buyer that the quality and characteristics of his product best meet the buyer's needs. In the case of unstandardized products this process of convincing the buyer of the quality of the product must take place every time the goods are resold. This indicates also that in the case of products which are amenable to standardization a grade should be established as near the original source as possible.[13]

If the quality of a product could be definitely known, as the result of an impartial measurement of its quality and of

bushel of quantity, 2150.42 cubic inches, is the one standard), and dishonest weights are frequent. But relatively, at least, the above is true. Hampers, baskets, tin cans and other containers for both farm and manufactured products are far from uniform. Progress is being made, however, by governmental action and by associative effort.

[13] "In fact many dealers as well as shippers insist that instead of having official inspectors at receiving points it would be of more benefit in preventing waste and loss if Federal inspectors were located at all shipping points to inspect the quality, grade, and quantity of all produce shipped. It is claimed that such an inspection system, working with a nationally established plan of standard grades and uniformly recognized sizes of packages, would prevent rejection without just grounds as well as does the present system, and in addition would better protect the dealer who buys f.o.b. loading station. It would also make easier the collection of damages for injury in transit. The exact grade, Nos. 1, 2, or 3, etc., could be marked or stenciled plainly on the package by the inspector. Under such a plan the purchasing dealer would be in a position to know just what he is buying, and eventually all foodstuffs would be sold according to the quality or condition."—*Report of the Federal Trade Commission on the Wholesale Marketing of Food* (1919), p. 82.

its peculiarly favorable or unfavorable characteristics in use, a large part of modern selling effort could be eliminated. Inspection by the buyer would become less arduous; and the mere puffing of one's wares as superior to those of another would then be confined to an endeavor to make the purchaser believe he needs a product with certain characteristics rather than other commodities which will gratify other wants —that he needs, for example, an automobile rather than a yacht, or a $2,500 automobile rather than a $600 one. Once the buyer has decided that question he would be able to determine for himself—on the basis of grades or recognized descriptions of quality—just which product meets his need. From the consumer's point of view it might even be well if he could be left alone in making the whole decision.

What Has Been Done.—Obviously the ideals which have been presented cannot be completely realized. Nevertheless, much that is here suggested is already in operation in the marketing of certain products and much more can be done with advantage.

State and Federal laws have been passed to standardize weights and measures and to bring about greater uniformity therein. Great progress has been made in grading the physical characteristics of commodities. The grading of agricultural products by associative action and by the state and Federal governments is becoming widespread. Standards already established are being employed over wide areas, and more is being done toward the extension of their use.[14] State food and drug departments are analyzing patent medicines, as well as foods, and helping the consumer to know what he is buying and what physical values he is getting for his money. In many lines semi-monopoly has resulted in a limitation of kinds of products put on the market, and that of itself simplifies the consumer's purchasing problem. Trade associations have attempted to establish standards, such for example, as the

[14] See Harold W. Samson, *The March of Standardization*, Separate No. 850, from U. S. Department of Agriculture *Yearbook*, 1920.

meaning of certain terms as applied to mechanical devices, hardwood lumber, colors, fabrics, and the like.

A large number of engineering societies have interested themselves in the establishment of standards. One of the most important of these is the ~~American Society~~ for Testing ~~Materials.~~ It is organized to cover a wide field including "structural timber, steel for all purposes including railway rolling stock, rails, structures, and castings of all kinds, standard magnetic tests of iron and steel, copper for electrical and other purposes, bronze, cement, fire proof materials, road materials, paint, coal." Nearly forty standing committees exist to facilitate this work. In order to coördinate the work of various societies five national engineering societies have organized the American Engineering Standards Committee and the United States Bureau of Standards now covers a wide field in assisting to establish such standards.[15]

The grading of attributes of products is more difficult. This is due to the fact that individuals differ greatly in the manner in which the attributes or services of products appeal to them. There will always be personal likes which react differently, even to standardized products. This fact renders possible much of the competitive selling of goods—the pitting, for example, of Smith's soap against Brown's and the rest of the field. Since the consumer does not know just what qualities and attributes of many kinds of products appeal most to him, and since different consumers are differently affected, vendors find it is advisable to differentiate their products from competing goods. If the differentiated product appeals to buyers, good will can be created for it. Then, with the product differentiated and standardized, the demand thus created can be satisfied only by the purchase of this particular product.

[15] See C. A Adams, "Industrial Standardization," *Annals of the American Academy,* Vol. LXXXII (March, 1919), pp. 289–399. Other articles on standards also appear in this volume.

CHAPTER XX

COMPETITION AND PRICES

I

The matter of fundamental interest in the market is price. Buyers and sellers alike are constantly watching prices—the central facts in the market. The consumer seeks, in the end, service and quality; but service and quality being what they are at a time, price is the point of interest to him. To the producer—manufacturer, mine operator, farmer—the price received for his product, a given volume assumed, measures his margin above or below unit costs. Or price may determine his volume of sales, and if his expenses vary with the volume of sales or with the scale of production, prices will have varying effects on the ultimate net profit. For the merchant, price determines the margin on which he must operate in any given transaction, and the markets in which he can buy and sell. (Both producer and middleman are interested in prices, not only as determining their volume of sales and margins of profit, but also because they determine the expense of doing business as shown in the price of raw materials, machinery, labor, funds, land, and services—the costs which must be met if the business is to continue.) And the uncertainty, which surrounds these prices and the prices at which the goods produced are sold, determines the margin of profit above expenses which business men must make in order to continue to carry on their particular operations. That is, when prices are uncertain this margin must be great enough over a period of time to offset the losses which occur. This means

that when the risk of changing prices is great higher prices must prevail.[1]

Price Defined.—The price of an article is its market value expressed in terms of money. Market value is power in exchange. The price of an article, or service, therefore, is an expression in terms of monetary units of the power which that article exercises in exchange on the market, i. e., of the money it will "buy," and hence, ultimately, of goods and services for which it can be exchanged.

This is not the place to go into the intricacies of price theories as developed in treatises on economics. Important as such studies are, they must be assumed here, and our purpose must be served by a brief summary of the chief conclusions which are generally accepted by students of the subject. A summary of this kind will serve as a background for the more specific study of market price which is the subject of the following chapter. This purpose will be effected by reviewing briefly how prices affect the production and the consumption of goods and services.[2]

Competitive Prices.—In modern industrial countries prices are generally determined under competitive conditions. And although no price, perhaps, is determined on a purely competitive basis—because of various kinds of friction which keep the normal competitive tendencies from complete operation —it is nevertheless true that the main influences upon prices are operating under competitive conditions. It is therefore important to summarize the manner in which prices would be determined in a purely competitive régime. This will also serve to make clear the nature of competition. The various

[1] See Theodore Macklin, *Efficient Marketing for Agriculture* (1921), pp. 326–327, and F. H. Knight, *Risk, Uncertainty and Profit* (1921).

[2] For a more detailed study the student is referred to the standard texts upon economic principles and to such references as may be given therein. Among the more accessible of these are the texts written by Clay, Ely, Fisher, Seager, Taussig, and Taylor. Professor Alfred Marshall's discussion of value and price in his *Principles of Economics*, Book V, is generally considered the best presentation of the subject.

elements which tend to counteract the competitive determination of prices can then be summarized.

In a smoothly operating competitive régime the prevailing price would be one which would bring on the market at any time just that volume of goods which would be bought at a price sufficient to cover the expenses of production, i. e., the expense of making and distributing the product, in addition to a net income to the business man sufficient to make him continue his efforts. If prices fell below this point, production would be immediately decreased and the volume of goods reaching the market would be reduced. As the available supply was reduced some purchasers—because of their intense desire for the commodity—would bid a higher price for it in order to get the share of the now reduced supply which they desired. This increased competition among the buyers with the more intense desire would eventually force prices up to a point which would cover the expense of production. If prices became higher than the expense of production, production would be increased—because producers would desire to take advantage of this opportunity to secure greater profits—and a greater volume would be offered for sale. This would continue until the competition of producers—coupled with the declining intensity of demand for the product on account of the increased supply—again forced prices down to the cost point.

When prices are low consumers tend to buy more, when prices are high they tend to buy less; when prices are high more is produced, when prices are low production is curtailed. With both production and consumption sensible to price changes the volume of goods offered and the volume which is purchased change as prices change. Thus, as prices rise, demand (consumption) tends to fall off; but the supply offered tends to increase and more production is called forth, because large profits can be made at the prevailing prices. When prices fall below expenses of production, demand (consumption) tends to increase because of the reduced price; supply, however, tends

to fall off and production is curtailed, because profits are small or do not exist. That is, a high or a low price, in relation to expenses of production and to previous prices, has an effect on both consumption and production—on demand and supply.

Varying Costs of Production.—Up to this point it has been assumed that costs of production are uniform for all units of the product. This would perhaps be true did competitive conditions work themselves out smoothly and quickly.[3] In fact, however, in industry as it is, costs of production are by no means uniform, but vary as between producers; and the same producer may have different costs of production under unlike circumstances, and with varying volumes of production. In the end, it is the price which consumers will pay that determines the volume of production. If that price is high, and if an enlarged supply is demanded which can be had only at increasing costs, then the higher cost production will be called forth by the high prices offered. But if buyers will not pay high prices, the high cost production is eliminated. Or, if looked at from the consuming side, should prices be high, many consumers will be forced out because they cannot, or will not, pay them. Demand is thereby lessened, the supply becomes relatively greater, and, with declining prices, the goods produced at a high cost will have to be sold at a loss. This will continue until some portion of the higher cost production is withdrawn, when, with the supply smaller than before and with the demand relatively larger, consumers with the more intense desires will compete for the smaller supply and the expenses of the remaining high cost producers will be met. On the other hand, if the demand of consumers is greater than the supply, some of them will bid the price up. This will allow the higher cost production to come in, thereby increasing the supply.[4]

[3] See F. H. Knight, "Cost of Production and Price over Long and Short Periods," *The Journal of Political Economy*, Vol. XXIX, No. 4, (April, 1921), pp. 304–335.

[4] If expenses of production increase as individual producers increase

Diagram VII suggests the influence which competition tends to have upon price, through the action of producers and buyers. The conditions shown more nearly conform to the facts as they are likely to exist in the actual market, for if competition were affecting these conditions as we have assumed, the dotted lines and the solid line would be one. That is, production facts and purchase facts would be known by all in-

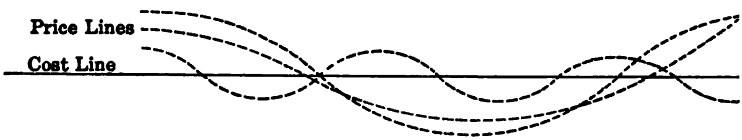


DIAGRAM VII.—*Effect of Competition on Prices.*

NOTE: The broken lines indicate prices, one of which changes more rapidly than the others, but with smaller fluctuations. When the lines are above the cost line, relatively low production is indicated—a condition leading to increased production, unless demand declines. When the price line is below the cost line, relatively large production is indicated—a condition leading to reduced production, unless demand increases.

terested parties, and consequently the supply placed upon the market would always be just that which would be taken ("demanded" in the economists' terminology) at the cost price. The cost line as a straight line indicates a single uniform

their volume of production, an enlarged demand will tend to bring more individual producers into the market, rather than to cause an enlarged production on the part of existing producers. If expense decreases as individual producers increase the volume of their production, an increased demand will induce existing producers to enlarge their operations, rather than to call new—and probably high cost—producers into the market. Production will be "large scale." If expenses are constant, either may happen, although existing producers can usually expand more rapidly and with less risk than can new and inexperienced producers. No matter what is the general tendency in an industry, it is usually true that high cost and low cost producers are found. In the long run the high cost producers tend to be weeded out, either by becoming low cost producers themselves—through imitating low cost producers, or themselves improving methods—or because they are eliminated by the competition of the low cost producers.

cost. As has been shown, this assumption seldom conforms to the facts.

Some Causes for Variations from the Normal.—But the conditions as outlined up to this point are by no means fully realized on the market; on the contrary, wide variations are found. Supply is not readily and quickly adjusted, made larger or smaller at the will of producers; and the news of the market, i. e., of the facts of demand and supply, is neither so widespread nor so accurate as was assumed. In fact, with the exception of prices fixed by custom or the dictates of convenience and of certain partially controlled prices—monopoly prices and prices fixed by the government—the reason for the failure of prices to conform closely to cost of production rests finally on the failure of our market news to indicate these facts accurately and quickly.[5] For if the market could be gauged far enough in advance (it would have to be for years in the case of goods produced by modern roundabout methods of production) prices would conform very closely to costs. Then producers could forecast markets accurately, and their efforts would be so well distributed in the production of the various goods and services desired, that, in the absence of monopoly, the interaction of supply and demand for all products would result in a cost (or normal) price for all of them all of the time. Just in so far as such news is made available are large speculative gains and losses eliminated, or at least, their magnitude is reduced.[6]

Two Types of Price.—So slowly, in fact, is correct market news disseminated, and so rapid are the changes that actually take place from time to time in the factors that affect the immediate demand for products and their supply, that economists sometimes speak of two kinds of prices as existing under a competitive régime. One of these is the *market price* or the actual price which prevails from day to day. The

[5] See Chap. XVIII.

[6] This will be more fully discussed in Chap. XXI; see also Theodore Macklin, *Efficient Marketing for Agriculture* (1921), pp. 306–312.

other is the *normal price,* that is, the price which tends to prevail over a period of time, and, hence, the price which will bring upon the market just that supply for which purchasers will pay enough to cover the expenses involved in production and marketing.[7]

Fundamental Importance of Demand and Supply.—All the market forces which one can think of—monopoly power, custom, advertising and selling, speculative dealing, government regulation of price and service, and consumptive regulation—are important as they affect demand or supply, or both; and are important in the market chiefly as they have such effects. But modifying influences, such as those just mentioned, are found in the determination of all market prices, and consequently tend constantly to keep them from being at one with normal price.

Normal price really represents a minimum and a maximum price. It is the cost price, below which prices cannot go for any long period of time if production is to continue. It is likewise the price above which prices are not likely to continue for long, if competitors are free to come into the field when prices rise. This is true because the increased profits of high prices would lead to greater production. Such a result would cause increased competition among sellers and, in the end, lower prices. The actual market situation is such, however, that in varying degrees supplies do continue to come on the market at less than cost for long periods of time;[8] and, on the other hand, in varying degrees producers are not free to come into the field when prices rise above costs. The more

[7] It is this price which is apparently in mind in many discussions of a "fair price," particularly by farm and trade associations. See Macklin, *op. cit.,* pp. 324–325, 333; and H. C. Adams, *A Description of Industry* (1918), p. 167; also P. W. Ivey, *Principles of Marketing* (1921), pp. 226–227.

[8] This is well illustrated by the losses manufacturing firms have been taking during the present period of readjustment. They have continued to operate, though often at a loss. See also pp. 352–354 and pp. 380–381.

fundamental of those conditions which affect actual market prices are the subject of the remainder of this preliminary discussion.

II

On the assumption that all prices tend toward the normal price of their kind, i.e., toward cost of production, it remains to explain some of the more important conditions which tend to keep actual market prices from reaching the normal price. These conditions can be summarized: (1) the failure to properly forecast market tendencies, (2) monopoly, (3) government control, and, finally, (4) custom and convenience.

(1) Speculative Prices.—Speculative prices prevail throughout the business world. In a sense, all prices are speculative, because knowledge of the actual conditions which will prevail on the market at a future date, near or distant, is never complete. Even the most perfect news service cannot report the many possible changed situations that may arise between the time the market is forecasted and the time the prospective exchange actually takes place. Not only may changes occur in conditions affecting production, such as an improvement in methods resulting in cheaper processing or better products, or both, but changes in demand likewise arise. A panic, a war, a "dry" law, a cyclone, a new product or method, may, one or all, alter the nature and amount of the demand for goods. The interaction of market forces is so complex and the apparently extraneous circumstances which have, nevertheless, a considerable effect are so many, that an accurate estimate of market conditions which will prevail at a future date is often practically impossible. This is true, of course, especially of articles which require long periods of time for their production, or of articles for which the demand is more or less precarious and elastic—as with seasonal style goods. These conditions prevail to a large degree in the market for most machine-made products, and similar problems arise in the market for farm products. There are, consequently, likely to be alternating gains and losses on the

market. These result from over- or under-estimation of the market demand or supply, and cause gain or loss, greater or less according as the estimates are more or less remote from the actualities.

(2) **Monopoly.**—Monopoly affects price from the side of supply.[9] It implies control of the price at which goods will be offered for sale. This arises from the unified control of the supply of a product or service, as when the government has a monopoly of the postal service, or grants to some producer through the patent or copyright privilege the exclusive control of the sale of certain products; or as found when a given entrepreneur or a group of coöperating entrepreneurs control a limited supply of raw material, such as anthracite coal, diamonds, iron ore, or of a finished product, such as gasoline or sugar. In cases of this kind, although the monopolist cannot dictate prices at which the consumer will buy as is sometimes assumed, it is true that he can fix the price at which the goods can be purchased.

But the power which the monopolist is able to exercise over the price he will charge for his product varies greatly under different conditions. It may usually be assumed that the ordinary monopolist desires profit. For that purpose he has produced goods or obtained possession of them or of services. But profit necessitates sales, and so he wants to sell. The amount which he can charge individual purchasers is obviously limited, at the extreme, by their purchasing power. Within this limit, determined by consumer purchasing power, the price which the monopolist can charge and yet sell his product will be limited by (1) the elasticity or inelasticity of the consumer demand, (2) the ease with which other products can be substituted for the monopolized product, and

[9] The term is also used to include control from the demand side. Thus Ely describes monopoly as "combination and unified action, signifying restraint on the free offering of commodities and services by rival sellers and on the free purchase of these commodities and services by rivals who desire to secure them."—R. T. Ely, *Outlines of Economics* (3d ed., 1917), p. 190.

(3) the fact that the government may interfere if prices are too high.

The elasticity of consumer demand is determined both by the intensity of desire and the extent of the income. If salt could be monopolized, as it has been at times, the inelasticity of the demand would make it possible for the monopolist to raise the price to unheard of heights. And there would be no limit, save his resources, to what the consumer would pay for water if it were monopolized. If sugar, on the other hand, were monopolized, although consumers might pay a much larger share of their income for it than they are now in the habit of paying, a point would, nevertheless, be reached where they would go without sugar, substituting corn syrup, maple sugar, or other sweets; or if need be they might even go without sweets of any kind. If the necktie market were monopolized and prices raised, a point would be reached relatively soon at which consumers would begin to go without neckties. Social custom might induce one to pay exorbitant prices, but there are many other things for which the desire is so intense that one would give up neckties rather than go without those more desirable things.

Consumer Desires Limit Monopoly.—The fundamental limitation to monopoly price, as to all prices, is the consumer demand. Individual consumers have different incomes and different desires. If desire is not intense a high price cannot be charged, or else consumers will go without. A few may have a very great desire for the product, others a moderate desire, and yet others no desire at all. The last cannot be induced to buy at any price; the first will buy at a very high price; those with moderate desires will purchase only when the price is low, because their desire is so limited that a point is soon reached at which they obtain greater satisfaction in spending the same part of their income in other directions. But consumer desire is limited in its market influence by consumer income. Desire may be very great, but the amount which each can spend is obviously limited

by his income, so that a very high price would in any case shut out those whose income was small.[10]

The ideal monopoly price—that which will bring the monopolist the greatest net income—must be determined with such considerations in view. For most products the choice must lie between (1) high price and high unit profit, but a small number of sales, and (2) many sales on a small unit margin of profit. This is, of course, a statement of the price problem as met by many sellers, but the ordinary seller must make his price conform closely to the market price, or else his competitors will undersell him. The monopolist, on the other hand, controls the total supply of his product and has no such competitive limitations. He can charge what price he will; and he will not, cannot, be undersold. His price problem is to use this power so as to secure the largest net return.

Determining Monopoly Price.—In order to gain the greatest profit the monopolist must determine what price will give the greatest margin between total expense and total income. In doing this he has little definite knowledge with which to start. He may know his costs of production and selling; although if it is a business of increasing or decreasing expense he cannot know even this with accuracy. But he does not know what reaction he will receive from the consumer at different prices, except after trial. Of course, if he is wise, he will study his market so as to estimate the best price, but aside from that he must experiment. Probably few monopolists, if any, have ever hit upon the best price for their article, and if they did, the price would be but temporarily the best, for conditions affecting expenses, demand, wants, and income

[10] A monopolist may sometimes, however, charge different prices, and so take advantage of different incomes. This is most feasible when the product can be varied to give different degrees of quality to the same fundamental product. Two familiar illustrations are the sale of books in different bindings and at different prices, and the sale of phonographs at varying prices. In each case an appeal is made to different buying strata by changes which are confined primarily to finish, or "quality."

are constantly changing. Furthermore, undoubtedly many firms possessing a monopoly, or even a degree of monopoly, have not tried to exercise their power to the limit. This, ignoring any more altruistic motive which may influence them, is on account of their fear that, if their monopoly does not rest on some exclusive privilege, competitors will be induced to enter this market, that substitution will take place, or else for fear—generally in the case of important commodities of every day use—that popular indignation will force the government to take a hand.

Semi-Monopoly Power Common in Competitive Lines.— In the competitive market somewhat of monopoly power is exercised as a result of the demand-creative efforts of producers, coupled with the force of custom or habit on the part of consumers. When a consumer is in the habit of purchasing at a certain store it often takes a considerable inducement in price or service to make him change. Again, he may have bought a particular brand of goods for years, and when the price is raised he will continue to buy it, although if he were coming into the market for the first time he might refuse absolutely to pay so high a price. The seller, through national advertising, local advertising, the use of salesmen, or the coöperation of middlemen, creates in the buyer a desire to buy his particular brand of product, and just in so far as he is able to induce buyers to ask for and insist on getting his product he has a monopoly of his market.

Influence of this sort does not, it is true, usually carry with it any large influence over prices. For if the price is much higher than the price of competing products, the buyer is likely to purchase the competitor's goods. But so long as price and quality remain approximately the same, the created demand will combine with the established custom as well as with the desire of the purchaser and assure to the seller his market. It is this fact which makes effective the large part of selling effort. That is, once the customer is won over, he

ordinarily continues to buy that product over and over again.[11]

It is these "repeat sales" that make economical much of modern selling. Take chewing gum as an extreme example. Over $3,000,000 is reported to have been spent on advertising last year by one manufacturer. At a selling price of a penny a stick that was the equivalent of the market price of 300,000,000 sticks of gum—three for every inhabitant of the country. Advertising on this scale is profitable only if, when once a sale is made, "repeat" sales follow. The cost of the initial sale is gradually spread over the later sales. The later sales are made because after the consumer was induced to make the first purchase, and found the product satisfactory, a smaller sales effort, or none at all, was required to procure each additional sale.

(3) Government Control and Operation of Monopoly.—It is plain that the monopolization of a necessity of life may prove to be a very terrible power over the pocketbooks and even the lives of consumers. Monopolies of goods or services of peculiar importance to the welfare of the general public, consequently, are often owned by the government; and usually are at least subject to its control over rates and service. The operation of public utilities is naturally monopolistic, because it involves the economies of large scale production, including the elimination of the wastes of duplicate competing plants, and because certain monopoly privileges in the form of franchises, such as the permission to use public highways, are an essential element in operation. These are usually controlled to protect consumers against extortionate prices, and to assure extensions of the service to parts of the community where it should go but where a private firm might not find profit in extending it, and so where it would not be carried if no control were exercised.

[11] This is usually called good will. The protection of this good will is the basis of the price-maintenance argument, discussed in Chap. XXII.

(4) Customary and Convenient Prices.—Competitive prices are also limited by custom and convenience. Dealers become used to charging certain prices, and consumers become used to paying them, and whether expenses go up or down, often within wide limits, prices remain the same. This is especially true of retail prices, which by no means conform to the many and frequent changes in wholesale prices. A grocer may sell a pound of coffee at forty-five cents for years, whereas the actual price he, or his jobber, pays may vary nearly every week; but very often only a considerable change in the wholesale price, which appears to be relatively permanent, will induce him to change the retail price. Shoes of certain manufacturers were advertised for years at established prices, but despite the rising costs of recent years it was not until the upheaval in expenses resulting from the World War that changes were made. General prices mounted for some time before a change was made in the price for a shave or haircut. Such customary prices are often hard to explain. But they make marketing much simpler to both seller and consumer and help to decrease price bargaining in small purchases—through making more evident the one-price-to-all policy. They eliminate bargain hunting for the products and services of ordinary consumption. Customary price is convenient to the dealer and to his customers.[12]

[12] See also pp. 426, 436–438.

CHAPTER XXI

MARKET PRICE

I

In the last chapter an attempt was made to summarize what may be called the long-time tendencies of market price. In this chapter some more specific considerations of market price will be discussed.

It has been shown that in the long run prices tend to conform to costs of production. This tendency is particularly manifest under competitive conditions. That is, market price tends toward, or fluctuates about, normal (cost) price, unless a deterrent force—monopoly or some scheme of market control, for example—prevails. At a time, however, costs of production have little to do with determining market price. For the strength of the existing demand of buyers sets an upper limit above which the price cannot go, regardless of costs. Furthermore, market prices tend constantly to change, as a result of the variation in knowledge of fundamental conditions possessed by traders, the strength of consumer desire, and the need of sellers to realize on their merchandise. At any one time, the estimates which traders make of conditions of demand and supply, present and future, determine the actual demand and supply which is effective in the market—whether they reflect the true potential conditions or not. The extent to which these estimates are correct over given periods determines how closely market prices will conform to costs, as well as the range of fluctuations in prices over shorter periods.

Price Limits.—In the whole range of prices from producer to consumer, it has been shown that certain fairly definite

ultimate limits exist. The lower limit to price is the expense of production and marketing of the highest cost producers and distributors whose products and services are demanded.[1] The upper limit is the price buyers will pay for an existing supply. These, however, are simply normal price limits which are effective over a period of time. Market price may go above the latter limit, and below the former. But if it does go above the latter, demand will be decreased, the full existing supply cannot be sold, and prices must drop in the end, if the total consumer demand remains unchanged.[2] That is, there will usually be some demand at the higher price but not enough, so that in the end some products (of the existing supply) will have to be offered at lower prices to be sold. If prices go below the cost of production a part of the existing supply is likely to be withheld,[3] and if in the end, it must be sold at a price too low to satisfy the producer, the ultimate result will be a reduction in further production, perhaps even the destruction of part of the existing supply.[4]

Importance of Retail Prices.—In the final analysis the prices which sellers can charge are determined in the retail

[1] See F. W. Taussig, "Price-Fixing as Seen by a Price-Fixer," *Quarterly Journal of Economics*, Vol. XXXIII (1919), pp. 205–241.

[2] It often happens in the wheat market, for example, that the visible supply and the receipts at a particular market are unusually small. This condition, or either one separately, if demand is normal, or unusually large, will often force prices up temporarily.

[3] This is normally assumed, but is not always true. It has been frequently noted that on a falling market holders become panic stricken and hasten to sell so as to avoid what they fear may be a greater loss. This of course accentuates the decline. Farmers frequently do this when the price of grain falls sharply.

[4] There may be direct destruction, but it is more likely to take the form of plowing under a crop, failure to harvest, or failure to market the crop, and a decline in future production. Since the increase in freight rates many examples have been cited of perishable products consigned to markets and sold at prices which did not cover the freight charges. See *Economic Conditions, Governmental Finance, United States Securities*, the monthly letter of the National City Bank, New York, March, 1921, p. 3.

market. It is true of retail prices as of other prices that the cost of production (including marketing costs) sets a lower limit below which they cannot go for long if production is to continue. If expenses are not met the retailer or jobber will fail, or if they do obtain their margin (above the price they pay) out of low priced goods, prices to producers will be so low that they will refuse to produce more. On the other hand, the strength of consumer demand determines an upper limit to retail prices, and ultimately an upper limit to prices all along the line back to the producer, as well as to prices for production goods and equipment. It is true that under our modern "one-price" system of quoting retail prices an individual buyer must usually take or leave an article at the quoted price. He buys or not according to his income and to the manner in which the price fits into his personal scale of values. But in the end prices are limited by the demand of consumers in the mass. If prices are so high, for example, that enough buyers will not come into the market to take the total supply offered at a given price, the price must come down before all of that supply can be sold.[5] It follows, therefore, that in the long run it is the retail price which sets upper limits to prices at all preceding points, and that price is determined by the reaction of consumers.

Retail Price Determination.—These conditions which have been described simply set long time limits. The prices which are charged in retail stores are not determined directly by them. These are set in various ways: (1) at a certain "mark-up" above cost, (2) by custom or convenience, (3) by an estimate of what the most satisfactory price will be, (4) at a price suggested by the manufacturer, (5) as a result of price understandings with competing stores, and (6) by following the prices set in competing stores.

(1) The "Mark-up."—A common method of setting retail

[5] It is these phenomena which economists describe in explaining "marginal utility" and "marginal vendibility." See F. W. Taussig, *Principles of Economics* (3d ed. revised, 1921), Chap. X.

prices is to add a normal "mark-up" for the particular line of goods to which a product belongs. This mark-up is added to the cost of the goods to the store and normally includes the estimated cost of selling that particular class of goods plus such profit as the store decides that it should make.[6] These normal mark-ups may be accepted throughout a particular trade, or they may apply to a store as a whole, to particular departments, to particular lines, or to individual commodities.

A price set in this way, however, is always tentative—to be raised or lowered as market conditions dictate. If there seems to be a very great demand, the price may be increased. If demand falls off, the price may be reduced in order to stimulate further demand. Retailers do not, however, always reduce prices. They may increase their sales efforts, or they may simply accept the small demand for a particular article and make no effort to increase it. In the latter case they will thereafter reduce the volume of purchases to correspond to sales, or refuse to buy additional stocks. In the merchandising of staple lines purchases are easily adjusted to sales in this way. Stocks can be held and slowly sold at the price marked. But with style goods or with staples which are a considerable part of a merchant's line this is not a wise policy. If staple goods are a considerable part of a merchant's line, or his complete stock—for example, shoes, drugs, groceries—and his prices are too high, the effect is obvious. Style goods are usually bought in advance of the season, and if they do not move at the desired price something drastic must be done at once to get them on the market. Unlike staple lines they cannot be held over; for as time passes they come to correspond less and less to the demands of the market, and so the longer they are held, the greater the ultimate loss that must be taken. If a greater demand cannot be created, lower prices must be fixed. Goods which

[6] Some of the common costs and gross profits in various retail lines will be found on pp. 509, 515–516.

are physically perishable present much the same problem. The low "Saturday night" prices for tomatoes, peaches, and strawberries are often accounted for in this way.

(2) Customary and Convenient Prices.—In addition to normal mark-ups in given lines or departments there prevail in many trades more or less customary or convenient prices.[7] Prices can be named and change made more conveniently in "even money." Again when a price has prevailed for some time both seller and buyer come to take it for granted. With such goods large variations in the wholesale price may cause no change in the retail price. Furthermore, if the wholesale price increases to a point which nets no profit to the dealer it is by no means uncommon for him to solve the problem by discontinuing the product, or at least not to feature it, rather than to raise the price.

(3) Price Estimating.—The retailer, like the manufacturer, sets many prices by estimating the price which will bring the best returns. He may do this by comparison with similar goods in his own store and with the prices charged by competitors. His supply houses may advise him. And many stores depend to a large degree upon the judgment of competent clerks and department managers.[8]

(4) Suggested Prices.—In the sale of many branded and advertised products, the resale price is set by the manufacturer.[9] So long as the retailer abides by the manufacturer's price decision he is, of course, unable to influence sales through any change in prices. The manufacturer has taken that into his own hands. Ultimately, however, the same forces which would cause individual dealers to change their prices will force

[7] See p. 421. For an interesting account of a practice of this kind, and its effect on the prices charged by manufacturers and jobbers, see U. S. Tariff Board, *Report on Cotton Manufactures,* Vol. 2, pp. 532–570 (62d Cong. 2d Sess. [1911–1912], House Docs., Vol. 133, Ser. No. 6315). This is a discussion of customary factors in pricing cotton textiles.

[8] This is sometimes called "eye-value." See Paul W. Ivey, *Principles of Marketing* (1921), pp. 229–230.

[9] See Chap. XXII.

the hand of the manufacturer. Local conditions of demand will not be so well calculated, but widespread conditions are probably better calculated in this way—since the manufacturer is in a better position to study the wider market influences. In other cases the manufacturer does not insist on the maintenance of prices but suggests the price to the retailer, or perhaps prints a retail price on the article or its container.

(5) Price Understandings.—Another common method of determining retail prices is to set them in consultation directly or indirectly with other dealers. This is thought to be very common with staple products which are not branded, such as coal, sugar, and lumber. Uniform prices sometimes result from understandings brought about through local retail associations. Since there is little variation in the quality of generally recognized grades of such products it is evident that the consumer can shop for them and buy them in the cheapest place. This of itself would lead to uniform prices. But "shopping" of this kind also leads to excessive competition among merchants, to avoid which the retailers may consult with one another to determine a common price or normal mark-up.

It should not be concluded, however, that the existence of common prices in all stores selling a particular commodity is the result of an understanding between the stores. A condition of free, untrammelled competition with large knowledge of the market also causes uniform prices to emerge. It is very common, for example, for housewives to go from store to store comparing prices, and "shoppers" sent out from stores are constantly visiting competing stores to compare the price and quality of merchandise.

(6) Following Competitors' Prices.—The last sentence suggests another means by which prices are frequently fixed. Many stores determine their prices from the prices which competitors are charging. A single store often takes the initiative and others follow—marking their prices at, above, or below the competing price, according to their general policy. This may be a conscious process on the part of the stores

who imitate, or it may result indirectly from their endeavor to set prices in relation to competing prices on a basis which experience has shown to be wise. But since some stores are quicker to sense fundamental market conditions than are their competitors they come to set the pace and the others follow.[10] It is understood to be fairly common for middle class and cheaper department stores to follow rather closely the prices offered in the basement of the "high class" department stores.

Even when stores do not consciously follow a leader in this way—even when they themselves lead—they nevertheless follow prices in competing stores, and gather valuable information of their competitors from their own customers and from supply houses. Although a merchant has a definite way of determining the prices at which he will offer his merchandise for sale—such as cost plus a definite mark-up—he must usually consider the prices prevailing in competing stores and, within the limits which his experience and judgment show to be necessary, price his own goods so that they will compete successfully. Each store ordinarily watches its competitors with great care. In this way it is able to learn what competitors are doing and prepare to meet in some way any advantages which their prices, merchandise, or service may have in the eyes of buyers, before the buyers themselves are aware of them. To the extent that this is true it can be said that each merchant sets his prices to meet the prices of his competitors.

[10] It is quite common among manufacturers just as among retailers to follow recognized leaders in the trade. The United States Steel Corporation in the steel industry, the Reading Coal Company in the anthracite coal industry, the Standard Oil Company, the American Sugar Refining Company, and other large producers are closely watched, and their prices are followed by their smaller competitors. Even where there are no outstanding organizations, like those in the cases cited, there are usually one or two firms which are recognized as leaders in the trade and whose policies in regard to prices are quite generally followed.

How Prices Evolve.—There is, thus, really no beginning or end of the price-setting process.[11] Each vendor watches his competitors. Furthermore, even when prices are determined independently of competitors, truly new prices are seldom set, because the price-setting process is continuous. The prices to be charged for each new stock of merchandise, as well as for existing stocks, are built upon the prices which have prevailed in the past for the same or similar merchandise. These are modified only as the seller's knowledge of the market dictates. Seldom is a price built up anew. Prices once established tend to continue, until some new condition exists—in fact or in anticipation—which induces the seller to make a change. This is especially true of retail trade, in which market influences are much slower to affect prices than in the wholesale trade.[12]

II

Just as in the last analysis all prices are limited by what the final consumer will pay for finished goods, so on the other hand the price which must be paid for production goods and equipment, as well as for consumption goods, in order to bring them on the market, is determined by the price at which a sufficient number of producers can be induced to devote their efforts and resources to production. But the prices which are offered to producers at any particular time do not necessarily bear an immediate relation to that price. They are determined very largely by the immediate conditions of demand and supply, as manifested in actual offers and bids in the market.

Producers' and distributors' costs, it has been shown, set lower limits to prices—limits below which prices cannot long prevail if production is to continue undiminished. But it has also been indicated that the market price which is paid in a competitive market, at any one time, is determined by other

[11] See Wesley C. Mitchell, *Business Cycles* (1913), pp. 27–32.

[12] For the reasons for this see pp. 436–438.

forces. Costs affect it only as they may influence sellers to offer or withhold merchandise. The influence of buyers (consumers) in determining upper limits has also been disclosed. But how are the actual prices quoted in the market determined? Three general classes of merchandise have been distinguished in previous discussions: production goods, equipment, consumption goods. Somewhat different conditions surround the pricing of each.[13]

Prices of Production Goods.—Raw materials are production goods in the sale of which demand creation is unimportant. This is the case because they sell "at the market." That is, a market price common to all products of a given grade prevails, and the producer cannot normally modify this price through efforts at demand creation. He can affect it only by diminishing the supply offered on the market, i. e., through withholding a part of the existing supply or through reducing the production of future supplies. These conditions are not, of course, confined to raw materials, for with any product sold solely on the basis of known, determinable, material qualities, it is possible for buyers to test these qualities, or have them tested, for themselves. Manufactured products which are sold as production goods for further manufacture, or as parts to be assembled, are similar in this regard to raw materials, since they are largely purchased on specification or by grade.[14]

Prices of Consumption Goods.—Very different conditions exist in the marketing of products for use in personal consumption and for equipment. With these the producer, within broad limits, sets his price.[15] There is no definite market price at which the products of different sellers are sold or offered. On the supply side products can be withheld from

[13] Only one of these, consumption goods, is sold at retail.

[14] See pp. 93–96.

[15] Such are the prices set by cranberry associations and walnut growers to open the season, and the "bids" which machinery manufacturers make to buyers, and their catalogue prices, as well as most retail prices.

the market or production can be reduced. But the price of these commodities—in contrast with most production goods—can be influenced on the demand side as well, by the creation, modification, or diversion of demand. It is possible for the vendor of consumption goods to do this because the intangible elements in the appeal of his product cannot be definitely measured and graded. His product, furthermore, is bought in small quantities, and by those who usually have not the ability and surely not the time to test carefully even the material qualities of a product.

Prices of Equipment.—Many of the same considerations which apply to the sale of production goods, apply to the sale of equipment, but in a smaller degree, because it is frequently impossible to determine in advance the relative performance value of competing equipment. And this introduces demand creation as an important factor in making sales. In the case of new equipment which a producer or merchant has never used before, demand must be created for the new service. Equipment goods of this kind are called specialties: typewriters, adding machines, cash registers, mimeograph machines, etc., when first introduced were of this class. Furthermore, many of these are bought by inexpert buyers and in small volume, so that the comparison with consumption goods often holds at this point as well.

No Definite Market Price for Consumption Goods and Equipment.—There is, consequently, no definite market price for most classes of consumption goods and equipment. And so the price which the vendor sets is in the nature of a trial price, i. e., he estimates the best price at which he can sell his product, and then tries it out on the market to determine whether his estimate (or guess) is right. With the development of the one-price policy in wholesale as well as in retail sales this estimate has assumed large significance,[16] since price cannot be modified to meet the conditions which

[16] It is even more important when the manufacturer determines retail prices.

develop in individual transactions. The price prevails throughout a market and the value sense of individual buyers must conform thereto, or be made to conform, if sales are to result. But the best of sales efforts cannot effect this end if the price is too far out of line with the valuation which the bulk of buyers place upon the merchandise.

It is in this connection that Shaw points out that a vendor may sell at, above, or below the prevailing market price for similar goods.[17] The price he determines upon depends in large part on the kind of sales appeal which is to be used. If the product is to be sold very largely on a quality basis, it may be sold at a higher price than the usual market price for similar merchandise, and quality can be emphasized and price ignored or minimized in the sales appeal. If the goods are to be sold at less than the market, the manufacturer is very likely to place great emphasis upon the low price, i. e., to sell on a "price basis." In selling "at the market," he may emphasize both price and quality if he so desires, although the price argument cannot be made particularly strong unless the quality is superior to that of competing goods selling at the same price, or unless other manufacturers are selling on a quality basis at the "market plus."

It is not meant to imply that when products are priced at the "market plus," with quality emphasized and price minimized in the sales effort, that the vendor tries to sell at a price which is higher than the quality warrants. There is, nevertheless, a probability that the cost of producing this added quality is proportionately less than the increase in price. But the difference is not necessarily profit. It may go largely into the cost of the increased sales efforts which selling on a "quality basis" commonly imposes. But larger unit profits do often obtain, particularly when sales are made

[17] As he expresses it, prices may be at the "market par," "market plus," or "market minus." See A. W. Shaw, *An Approach to Business Problems* (1916), Chap. XV.

to so-called "high class" trade. The volume of trade, however, may suffer.

This possibility of emphasizing price in some cases and quality in others and, possibly conversely, ignoring price in some and ignoring quality in others, arises from three fundamental conditions, which have been previously emphasized: (1) the lack of recognized standard grades covering all important characteristics of the product, (2) the inability of consumers to compare competing goods, and (3) the fact that the same characteristics, in both consumption goods and special equipment, appeal differently to different consumers.[18] The inability of consumers to compare competing goods arises from their lack of skill and their failure to take sufficient time to analyze carefully and compare the characteristics of competing products, but the different reactions to identical products must be traced to the difference in individual tastes and characteristics and to variations in incomes. The different features emphasized in the sale of competing motor cars illustrate these points, and a rather extreme case is found in the publicity efforts of two cigarette manufacturers, one advertising its product as "all Turkish" tobacco, the other advertising its product as having "just enough" Turkish. Manufacturers of equipment, likewise, recognize these conditions by their efforts to add "improvements" to basic mechanisms, and by producing several models.

Consumer Demand Limits Prices.—The price which consumers are willing to pay for a given supply has an effect on all previous prices, which tend to be less than that price by the normal margins of the sellers in each preceding market.[19] Although it is true that particular prices tend to be determined from wholesale prices, wholesale prices really only reflect conditions of supply and demand. These are

[18] See especially Chap. VII and Chap. XIX.

[19] See Theodore Macklin, *Efficient Marketing for Agriculture* (1921), p. 322.

manifest in the producer and consumer markets, even though they may be first sensed in the wholesale market.

When middlemen know what the retail price tendency is they alter their offers to purchase to suit—unless higher prices are anticipated—so that the burden of low prices will fall on the producer who still holds his goods. Merchants who have bought at a higher price cease buying, and the retail supply may thus be temporarily reduced. When merchants need to renew their stocks, they will not pay more than the price they expect to receive, less the margin they want. But the producer (or merchant he has sold to) has the product and, in the end, must sell. Unless he can hold it over to a later time when supply is less or demand greater he is the one who loses most heavily. Likewise, when prices rise, those who hold goods tend to make the largest gains. The merchants continue taking their normal margins, and functional middlemen their normal commissions, unless prices rise very rapidly or they buy large stocks as a speculation.

III

Price Fluctuations.—Fluctuations in market prices vary as between different classes of markets, and different products. They occur with great frequency in the wholesale market and with far less frequency in the retail market. They are frequent but small in markets where future trading enables speculators and traders to discount future market trends. They are usually infrequent but large where no such future trading prevails. Furthermore, they may be controlled and stabilized by monopoly, combination, and association. Finally, fluctuations may respond but slowly to market changes, even under truly competitive conditions, because of the use of customary or convenient sums in naming wholesale and retail prices, because of the inconvenience of constant changes in price, and because prices are sometimes "maintained" by manufacturers of branded and advertised goods.

Prices in Different Markets.—The previous discussion has shown the limits between which market prices tend to fluctuate: what consumers will pay is an obvious upper limit to prices and the costs of production and marketing set a lower limit. It has also been shown that almost never is either of these a definable limit. Cost is not only a lower limit; it tends also, in a competitive market, to be an upper limit, which may be far below the limit determined by consumer desire. Over a period of time, therefore, market price tends constantly to fluctuate about costs—sometimes above and sometimes below.[20]

But there are various market prices prevailing for a given commodity, all of which, however, bear a close relationship to one another. For farm products there are the prices at which the grower sells the country shipper, the price at which the country shipper sells the wholesale receiver, and the price at which he, in turn, sells to the factory. For consumption goods there are the prices at which the country shipper or wholesale receiver sells to the jobber, the price at which wholesale dealers sell to retailers, and the retailers' price to the consumer.[21] Furthermore, there are many markets of each class usually spread over a wide territory, and almost innumerable transactions are carried on in each. In the market for manufactured goods a similar situation prevails.

Some of the most interesting problems of market price concern the interrelations between these various markets and the transactions in them. At one extreme is the prime producer; at the other is the final consumer. Between these there appears the distributing machinery, often comprising several classes of markets, and frequently one or more manu-

[20] See F. W. Taussig, "Is Market Price Determinate?" *Quarterly Journal of Economics*, Vol. XXXV, No. 3 (May, 1921), pp. 394–411.

[21] These are not exactly speaking prices for the "same product," since there is commonly a division of the product into classes of different size and quality somewhere after it leaves the farm.

facturing processes. It has been shown that the variations in price at the different steps in the distribution of commodities tend to conform to the costs involved. But is the retail price determined by adding a mark-up to the wholesale price; or does it work the other way, and is the wholesale price determined from the retail price? Is the price which the wholesaler pays determined by the costs of production of prime producers plus the costs and a normal profit for any marketing activities involved in getting goods into the wholesaler's possession? Or does it work the other way, so that the producer's price is determined from the wholesale price? And how closely do prices in one market follow prices in another of the same or different class? These and similar questions arise concerning market price. Their answers have been suggested, but they call for further discussion.

Prices in Different Markets.—Fluctuations in wholesale market prices, i. e., prices at which wholesale dealers buy and sell, are usually more frequent than are fluctuations in retail prices, or in the prices at growers' markets, or even in the prices at which manufacturers sell to wholesalers.[22] One general cause for this is the fact that market news reflecting actual or supposed conditions of supply and demand is first known in the wholesale market. Furthermore, since both buyers and sellers are skilled and are operating on a large scale they probably receive this news simultaneously. The price, consequently, is constantly forced to the point which market news, as interpreted by the wholesale dealers, seems to warrant.

Retail Prices.—Retail prices, i. e., the prices the consumer pays, fluctuate less than wholesale prices. There are several

[22] "In the entire price system, the wholesale price is most highly organized, most sensitive to changes, has more frequent but on the whole less violent fluctuations, and is usually the controlling price for both producer's prices and retailer's prices."—C. S. Duncan, *Marketing: Its Problems and Methods*, p. 237.

reasons for this.[23] (1) The consumer does not follow the market closely and consequently does not know of changes in the wholesale market. He is normally willing to pay the same price day after day, and is not often at all insistent that the retailer follow more closely the trends of the wholesale market. (2) The dealer buys his product in quantities some time ahead of his normal demand. In many lines it is the custom to "mark-up" the retail price at a certain per cent over the cost price. In a falling market the retailer does not wish to lower his prices so long as he is selling high cost goods.[24] In a rising market the inconvenience of constantly changing prices or the desire to make a good impression on his trade may keep him from raising his prices at once. Again, (3) customary prices prevail in certain lines, and variations are made only in even money or from one customary price to another. (4) Convenience commonly dictates that retail price shall not vary with every fluctuation in wholesale price. When one considers the large number of products handled in the retail store it is evident that the proprietor and his clerks cannot keep track from hour to hour or even from day to day of changes in the wholesale market. There are practical difficulties, furthermore, in re-marking prices. Aside from losing time in altering price marks, clerks cannot remember prices if they are changed too frequently, and confusion results. This is an important consideration with concerns in which many small articles are sold rapidly at a small price, such

[23] Some of these points were mentioned in the discussion of how retail prices are determined, but they are essential to the present discussion.

[24] This has been cited frequently as a cause for the failure of retail prices to reflect the reductions in wholesale prices which have taken place since the spring of 1920. By refusing to sell at the low price which actual (potential) supply would warrant, in view of the existing demand, retailers not only do not lower their prices but they refuse to buy a further supply, because their stocks move slowly and they do not need it. This causes a temporary shortage in the actual supply in the retail market.

as grocery, drug, hardware, and dry goods stores. (5) Normally the retail margin is so great that minor fluctuations in wholesale prices make up a very small per cent of the retail price. For example, many wholesale price fluctuations are less than one cent per retail unit whereas changes in retail prices cannot be less than one cent per sales unit, for change cannot be made, and with many retail lines price changes are customarily made in even sums of from five cents to one dollar. It is evident that in these lines minor wholesale fluctuations cannot be conveniently passed on to the consumer but must be absorbed by the retailer.

Producers' Prices and Wholesale Market Prices.—Factory and farm prices follow wholesale prices more closely than do retail prices, chiefly because of the larger scale on which the operations are carried on, and because of the purpose behind purchase and sale. It has already been shown that when purchases are made in small amounts—as at retail—the buyers are seldom skilled, nor have they time to purchase with care. But in the farm market, as in the wholesale market, trading is in larger volume and more care can be used. Furthermore, the consumer's surplus has an important effect on retail purchases but it has practically none on transactions at other points in the marketing machinery. A consumer is buying to consume—to meet essential needs, and to procure comforts and pleasures. He cannot measure these accurately in terms of their money value, but if he could he would find often that their money value in his estimation was much greater than the actual price he pays. He does not therefore estimate each time he pays seven cents for a loaf of bread, fifteen cents for a can of soup, ten cents for a cigar, or two dollars for a theatre ticket whether he will get just that much satisfaction out of his purchase. This is one important explanation of the lack of frequent fluctuations in the retail markets. But this is not the case with the other buyers in the market. There is a definite money measure for the business value of their purchases. Whether they be manufacturers

or merchants, they must constantly consider whether a purchase at a given price can be resold at a profit. If the consumer pays seventy-five dollars for a suit of clothes which could have been purchased around the corner at sixty dollars and next month at fifty-five, he will suffer no direct misfortune. But the jobber or retailer who pays too much will feel the effect in a definite, tangible way—profits will decline or disappear. In the wholesale market a difference of a cent on each dollar's purchase is often the measure between profit or loss.

Producers' prices, nevertheless, vary less often than do wholesale prices. This is the situation with farm (local market) prices. In some trades prices in the central market vary many times in the course of the day. The factory and farm prices, on the other hand, unless there are extreme fluctuations in the wholesale prices seldom change more frequently than once a day, usually much less often in the case of factory prices.[25] But these changes are usually larger than the wholesale variations—as in even cents. In many farm markets, furthermore, competition is not usually keen enough to force dealers to follow the wholesale markets closely.

The Importance of the Wholesale Price.—There is, nevertheless, a normal relation between these prices. This normal relation between the wholesale price and the retail price on the one hand and the farm or factory price on the other is determined by costs. That is, the retail price is normally the wholesale price plus the costs of marketing of the various middlemen, jobber and retailer for example, and their mark-up for profit. In this way prices are "set." True, as has been shown, the market forces really work back from the retail price, but the wholesale trade senses the changes in the

[25] When manufacturers sell "direct" to retailer or consumer their prices are often uniform for a considerable period of time. This is particularly true of manufacturers of advertised and identified merchandise. Even the prices at which they sell jobbers tend to remain unchanged for considerable periods of time.

retail market before the retail trade senses them. This predominant position of the wholesale price is not, consequently, an indication that wholesalers can "determine" what price they will pay and receive. It is due to the fact that imminent changes which will have a widespread effect in the retail market, or in the country market, or on the factory prices of manufactured goods are commonly sensed in the wholesale market before they become evident to producers or retailers. That is, the market news of the wholesale market is superior.

The price offered at the country market and in less degree the manufacturer's price, are normally the wholesale price less the cost of buying and selling the product in the central market, plus other costs which the shipper must bear, plus his normal mark-up for profit. Both the cost and the mark-up vary greatly, however, as between various points. Transportation costs in particular vary, so that the subtraction or addition of that cost results in great variations in prices at different points, in relation to the price at a particular wholesale market. Variations in the cost of doing business are also great as between efficient dealers and those who are less efficient. That part of the mark-up, furthermore, which goes to profit varies greatly. Where competition between dealers is keen it is small, but where a single merchant has little competition and where agreements exist between merchants this margin is higher.

The Limits to Market Areas.—There are for many staple commodities a "world market" and a "world price." This price is determined at the point at which the surplus products of various producing areas come into contact. When there is such a world price, determined in the centers of manufacture and consumption to which the surpluses of the producing areas are sent, prices in the producing areas and in all intervening markets tend to conform thereto. The degree of conformity is greatest in those staple articles, such as wheat and cotton, in which an organized future market discounts

in advance the effect which conditions influencing demand and supply will have, and tends to keep prices between markets "in line." It has just been shown that prices in the central wholesale markets reflect conditions of supply and demand most quickly, and it is in these markets that the world price is most evident. Retail prices and the prices at which manufacturers buy raw materials, as well as their prices to buyers, are also closely related to the central market wholesale price, and so, where it exists, to the world price. But this relationship, particularly in the case of retail prices, conforms less to the immediate conditions of demand and supply than does the wholesale price. There is such a "world price" for wool, cotton, textiles, iron and steel, important grains, and tobacco.[26] In fact, for all widely used or widely produced products which are consumed in some areas in greater quantities than they are produced, and which are produced in some areas in greater quantities than they are consumed, there tends to be a world price—in the absence of prohibitive marketing costs.

The best examples of a world price are found in the wheat and raw cotton markets. The world price for wheat centers about the Liverpool price. For Liverpool is the important import market of western Europe, and western Europe is the greatest wheat importing center in the world. It is here that the surpluses of the great producing countries, Russia, Argentina, the United States, Canada, India, come into competition.[27] The demand of western Europe draws wheat in that direction, and the price in the producing country must equal the basic price which prevails there in order to keep the supply it desires at home. That is, the Chicago price for wheat is normally the Liverpool price less the cost of marketing wheat from Chicago to Liverpool. The prices in other central markets in America follow this price also, or more likely follow the Chicago price and so follow the Liverpool price because

[26] Tariffs, however, impede the tendency in many lines.

[27] An interesting discussion of the "world" price for wheat will be found in L. D. H. Weld, *Marketing of Farm Products*, pp. 256–262.

the Chicago price does.[28] The price in local markets is likely to be the Chicago or other central market price less the cost of marketing from those local points to the central market.

Factors Which Limit Market Areas.—Where marketing expenses, especially transportation costs, are very high, the area in which a uniform price tends to prevail is thereby diminished. And there are other important factors which limit market areas. One of these is the fact that many commodities are highly perishable. And although improvements in transportation and storage methods have increased the distances over which perishables can be carried, and the time they can be held before use, there remain a number which must seek a limited market. Many fruits and vegetables are of this class. But even goods which are not perishable, and which are of sufficient value to afford transportation costs, often have considerable limitations in respect to the size of the market in which they will be sold at relatively uniform prices. The principal of these limitations have to do with the method of sale which is necessary, and with the confidence buyers and sellers have in their knowledge of future conditions of demand and supply.[29]

When goods must be inspected before a sale takes place, markets are limited because buyers cannot usually inspect the whole supply, or even a large part of it. This is a limiting factor for practically all commodities which are produced over a wide area and which are sold by inspection. There develop, consequently, many small local markets in which local supplies are bought and sold.[30] Even such markets, however, are interrelated. Some buyers and sellers are usually found who operate in more than one market, and

[28] This relation between the Winnipeg and Minneapolis prices for wheat and the Liverpool price is shown in the U. S. Tariff Commission, Tariff Information Series—No. 20, *Agricultural Staples and the Tariff* (1920), p. 62.

[29] See Macklin, *Efficient Marketing for Agriculture*, pp. 308–317.

[30] Most retail markets are of this kind, but so are the wholesale markets for many commodities.

they in turn come into competition with those who operate in yet other markets; and, furthermore, large operators may spread their activities over a wide area by employing trusted agents on whose judgment they are willing to depend. There may, consequently, come to be a rough relation between all such markets. When goods can be sold ~~by sample or description this limitation to the market~~ area tends to disappear, for buyers can then select from a wider territory.

When buyers and sellers have a sufficient knowledge of the future course of the market to be willing to hold surplus supplies, in case they are not able to sell at once at a price which corresponds fairly with what they anticipate future prices will be, prices are likely to be closely related over the whole market area. If there is an over-supply at one point at a given time, it will be held for a later time when the supply will be less, or—and this is the more important point—it can be shipped on at once, or later, to markets which promise better in the future. That is, there is a well organized market, in which differences in time and place utility are confidently discounted, and a wide market develops.

Is Market Price Determinable in Advance?—It is probably impossible to find any means for determining accurately at what price a product should be offered for sale. This is particularly the case with a new product, or with a new quality of an old product sold under changed conditions—for example, style goods in a new season. It may be that any one of a dozen different prices will sell enough of the product to leave to the vendor a satisfactory margin of profit. But it is seldom possible to tell in advance which one of these will prove to be the most profitable. It may even be impossible to know whether a given price will prove to be at all satisfactory. It has been shown elsewhere that profits depend on the volume of business and the unit profit per sale, and that different prices generally develop changes in each of these. But the extent of these changes, particularly in their effect on volume, can be forecasted with hardly any degree

of accuracy. This is true, primarily; because it is impossible to determine in advance what volume of sales will result from each of several prices, and what amount of sales effort will be necessary to sell at satisfactory volume at each price.[31] In other words, it is impossible to forecast the mind of the buyer accurately, and so the reaction of buyers to any price can be determined only by trial. The buyer's mind, furthermore, is changeable, and so the best price to-day may be an unsatisfactory price to-morrow. Clothing novelties, for example, may sell at a high price until they become common. Then stocks may have to be cleared out at a great reduction. Many stores do not restock novelties after the novelty aspect begins to wear off.

Style goods in particular are ordinarily sold at different prices in different times of the "season." Early in the season a high price can be set. The sales at that time are made to those who must have the product and to those who desire to "be in season" and to follow the styles. To these buyers, style and quality are the important elements. Later in the season prices may be lowered one, two, or three times. When the best selections have been taken the appeal must be shifted in part to a price basis. Buyers who are more interested in values than in ultra-style can be appealed to only at lower prices. Finally, the very lowest season's end prices appeal to those with small income and to bargain hunters. A price policy of this kind seems to be more successful in the sale of

[31] This factor of the cost of selling individual items is too frequently ignored. A product which the dealer does not need to advertise or display and which requires a minimum of demonstration and sales effort on the part of the salesman can be handled on a narrow margin with profit. But a product which must be advertised and displayed and which requires a large amount of time on the part of the sales force must be handled on a wider margin—a margin which will cover these additional costs. See R. E. Heilman, "What's the Remedy for Diminishing Profits?" *System*, Vol. XXXIII (1918), pp. 182–185, and L. D. H. Weld, "The Right Selling Price," *System*, Vol. XXXIII (1918), pp. 711–713.

style goods than would the policy of hitting on an average price for the season. Another example of pricing the same goods differently in order to appeal to different classes of buyers is found in the not uncommon method of selling different grades or classes of a commodity or service—crackers and cookies packaged and in bulk; first, second, and third class passage on boats.

Prices Constantly on Trial.—Any price is constantly on trial. If it results in a very large demand the seller may increase the price and in this way increase the net profit per unit sale. This, of course, can be done so long as the supply offered on the market by competitors is not increased to such an extent that competition leads them to cut prices; and so long as there is a sufficient number of purchasers willing to pay the higher price.

Increasing Demand at the Same Price.—If demand is slow, one thing which will usually enliven it is to lower prices, although that result by no means always follows reduced prices. There is another way of increasing demand which is often more effective. That is to try to influence buyers so that they will buy in larger quantities at the prevailing price. It is probably true that many products now sold in large quantities and at good prices could scarcely have been sold at all when they were first marketed without these efforts to influence prospective purchasers. This truth is well illustrated by the history of such specialties as typewriters and adding machines. If a particular product does not "move," it may be played up, consequently, in the advertising, featured in the show case, or displayed in the window, or the efforts of the sales force may be centered on it. It is stated, for example, that a bonus to the retail salesman of fifty cents, a dollar, or two dollars will sell a slow moving line of clothing much more rapidly than a cut of five to ten dollars in the selling price.[32]

[32] This has obvious ill effects. For example, salesmen are tempted to show only the goods offering the highest bonus.

Increased Demand through Lower Prices.—But if it is found that increased sales effort will not develop an increased demand at reasonable cost the next step must be to lower the price.[33] This may be done with no intention of calling any special attention to the fact that the price has been lowered. In such a case it is simply expected that a larger volume of sales will eventually result from the lower price. In other instances business men have large stocks of goods on hand which they desire to turn into cash as soon as possible. When this is the case the lowering of the price is a temporary expedient, the purpose of which is to reduce the large stock within a short time. Many retail "sales" are of this type, to speed the sale of slow moving goods, or seasonal stock left over at the end of a season.[34] Low prices are also used to make a "leader" of a product, either to give the impression that all prices in the houses are low, or to attract buyers in the hope that other sales will result.[35] Another example of lowering price to increase volume of sales is the case of the department store which sends slow moving products to the basement, where they can be sold at lower prices without jeopardizing the sale of similar products on the upper floors.

[33] The quality of the article or service may be improved. But so far as pricing is concerned a really different product is thereby placed on the market.

[34] Nevertheless retail "sales" are not so commonly of this type now as formerly. It is particularly true of large city stores that their sales are planned months in advance and goods are ordered for the express purpose of selling during the "sale." The "annual sales" of white goods, furs, furniture, etc., which are featured by department stores are mainly of this type.

[35] The relation of this policy to the problem of resale price-maintenance will be discussed in the next chapter.

CHAPTER XXII

PRICE-MAINTENANCE AND UNFAIR COMPETITION

I. Price-Maintenance

Some of the most important market problems center about the practice of price-cutting and the means used to eliminate it. The natural result of competition is to force prices down to a level just sufficient to induce producers and distributors to continue bringing the required volume to the market. But often the price goes below this point, and under modern conditions of production with heavy investments in plant, equipment, technical skill, and in the development of good will, it is not always easy for producers to leave one field of activity to enter another. There may be, consequently, long periods of time during which a given manufacturer or even whole groups of manufacturers continue producing at little or no profit and perhaps at a loss, in order to avoid the greater loss which would result from closing down.[1] And even though prices do not fall to this extreme, sellers look askance, nevertheless, at competition which is manifested by the reduction of prices.

Some Remedies for Price-Cutting.[2]—Very naturally, producers have done all they could to reduce the danger from

[1] And business men are commonly optimistic. They are usually expecting "things to get better," or the "turn" to come, in the very near future.

[2] There are many who do not agree that price-cutting is an evil. And surely without price-cutting it is hard to see how buyers are to benefit from the competition of sellers. But sellers commonly fear price-cutting and so long as they do they will endeavor to avoid what they conceive to be its evil effects. It is this fact which is discussed in this chapter, not whether price-cutting really is an evil, or a good thing.

extreme fluctuations in price, and particularly that from falling prices. But whether times are "normal" or bad, price-cutting tends to be present,[3] and its effects must be offset by competitors in some way. The most obvious method is to imitate the price-cutter and reduce prices. But this may lead to further cuts, and then more cuts. Sellers, consequently, prefer to use other means to avoid the difficulties of competition on a price basis, and they have evolved various ways of counteracting the price-cutting of competitors.

A temporary expedient has sometimes been to lower the quality of the product, so that it could be sold at a lower price ~~with profit~~. In other cases improved methods have enabled a manufacturer or dealer to sell at the reduced price and yet make a profit, or by improving the quality of the merchandise to continue selling at a higher price. Another ~~result~~ of price-cutting is the now familiar "trust movement." Manufacturers have sometimes combined in an endeavor to control the market and thus to maintain prices at a higher level.[4] Again, sellers have in recent years been forming "open price associations," through which they have endeavored directly and indirectly to influence prices.[5]

Emergence of the Price-Maintenance Problem.—In yet other cases individual manufacturers have identified their product, and through publicity—mainly consumer advertising—they have endeavored to build up such a demand that they can, within limits, refuse ~~to reduce the~~ prices at which they sell to the low level to which competition might otherwise force them.[6] But it is just at this point that manufacturers meet a new difficulty, and an important problem in public policy has emerged. Retail dealers soon saw in these well-known, branded articles an opportunity to make a strong

[3] There are many ways in which prices are "cut." See pp. 467–470.

[4] See, for example, L. H. Haney, *Business Organization and Combination* (1914), Chaps. IX–XVI.

[5] See pp. 389–390.

[6] See pp. 419–420.

appeal to consumers on a price basis. By selling such articles at a lower price than was customary, they could themselves realize on the good will attaching to the manufacturer's brand. This has been done in varying degrees. Some stores have used a few articles of this kind as "leaders," either to give the impression that all their prices were low, or simply as a drawing card to induce people to come to the store. Other stores claim to sell all goods at cut prices.[7] Again, all prices may be cut during "sales" at certain periods of the year. Seasonal sales for the purpose of selling out season-end stocks are not ordinarily of importance in the consideration of this particular problem. This depends, however, on whether the sale is really to sell out stock left on hand at the end of a season, or whether it is a regular, planned sales device.[8]

Although the reduction of the price at which the article is sold may greatly increase the sales in the price-cutting store, competing stores raise frequent objection, and in the end the manufacturer may suffer. Other dealers, it is contended, either will not, or cannot, or do not wish, to reduce their prices for the product. Yet with one store offering a well-known article at reduced prices, the customers of other stores may be disgruntled and there may even be a demand from them for the lower price. Since the product is identified and well-known, consumers buying in one store at the usual price, on learning that a rival store is selling it at a lower price,

[7] A representative of the R. H. Macy Co. of New York is quoted as saying: "It is a fact that we sell here on a cash basis strictly. . . . This means that we have no charge accounts, and that we are unable to offer to the public those facilities which go hand-in-hand with the credit privilege. Without these, we *must* offer some substitute inducement to bring the public to us. . . . Years ago we decided that it should be price inducements.

"It is our business working-principle to sell everything lower than it can be bought for elsewhere in any other competing retail establishment."—*Printers' Ink*, Aug. 4, 1910, p. 8. Quoted in P. T. Cherington, *Advertising as a Business Force*, p. 406.

[8] See p. 446, note 34.

may feel dissatisfied with the store in which they paid the higher, but "regular," price and perhaps refuse to deal further with it; or at best they will be likely to go to the other store to make further purchases of that particular article. In the end, it is claimed, the dealer who does not wish to lower the price will refuse to handle that product again, or at least will not be enthusiastic in pushing it. If the old price is maintained, he fears the loss of trade; if the lower price of the price-cutting dealer is adopted, he will make little or no profit, or may even sell at a loss.

In view of these facts it is further contended that the dealer feels aggrieved and the manufacturer loses trade; for the business of the price-cutting merchant is not likely to equal that of the combined sales of his competitors.[9] Furthermore, after the public enthusiasm over the cut-price has worn off, and the injury has been wrought, it is asserted that the price-cutter himself is likely not to attempt to push sales of that particular article. In fact, it is contended that he may use this as a device to draw consumers to his store, and later gradually substitute an inferior article of his own.

With one merchant cutting prices others are likely to demand a lower price from the manufacturer or from their jobber so that they can meet the competition. The jobber himself may also try to exact a lower price from the manufacturer. In fact when dealers find that a competitor is selling at a low price their first reaction is that the price-cutter has received a lower price from the jobber than they have. This may lead to ill-feeling, as well as to a demand for lower prices. So it is held that the jobbing trade may likewise suffer, and thus, as a result, the manufacturer's whole distri-

[9] But the advertising manager of a "widely-known toilet specialty" quoted in *Printers' Ink*, Vol. 72 (Aug. 25, 1910), p. 9, says, "In the cut price town the rank and file [of dealers] are 'unfriendly'—all advocating and advising 'price protection'—but in those towns the sales of the few big dealers selling our product on a comparatively small margin are so large and so satisfactory as to make us almost willing to forget that the small dealers are there at all."

butive process may suffer. Believing this to be true, the manufacturer fears the disorganization of his market, built up often after a long period of strenuous sales effort. He fears that it will be irretrievably injured from the price-cutting activities of a relatively small number of merchants, and other merchants importune him to "protect" them. To meet this situation some manufacturers endeavor to fix the price at which buyers—jobbers and retailers—shall sell the product.

Price-Maintenance: Defined; the Problem Stated.—Price-maintenance has been defined as "the marketing policy which consists of the imposition by the manufacturer of restrictions upon the price at which an article identified by trade-mark, brand, copyright, or patent may be resold by a purchaser or sub-purchaser." [10] In this definition can be seen the origin of most of the complications which arise in determining the legal, as distinct from the economic, status of the policy. Goods identified by trade-mark, copyright, or patent and on which prices are maintained, are sold subject not only to the common law but to the statute laws applying to each. The problem has not been settled, but the general tendency on the part of the courts seems to be to refuse the right of price-maintenance when the goods are sold outright, at least under plans thus far attempted. Most of the cases, however, have not considered price-maintenance on its economic merits but rather in connection with the rights conferred by statutes under the copyright, patent, or trade-mark laws.

Legal Status.—Prices maintained by combinations of manufacturers are contrary to the Sherman Act. And an agreement of a manufacturer with his jobbers and retailers has also been declared illegal under this act.[11] Agreements involving

[10] From H. R. Tosdal, "Price Maintenance," *American Economic Review,* Vol. VIII (March, 1918), p. 29.

[11] ". . . The complainant can fare no better with its plan of identical contracts than could the dealers themselves if they formed a combination and endeavored to establish the same restrictions, and thus to achieve the same result, by agreement with each other. . . .

"But agreements or combinations between dealers, having for their

a contract with first purchasers by which they agree to fix the price of resale by sub-purchasers at a point fixed by the first seller have also been held illegal.[12] It would appear, in fact, that it is in maintaining resale prices of sub-purchasers that the manufacturer's greatest difficulties arise. For, even though a particular agreement by the first purchaser to maintain prices cannot be enforced, there are many excuses which the manufacturer can find for refusing to sell, or for selling on unfavorable price conditions to the price-cutter to whom he sells directly.[13]

~~Legal Uncertainty.~~—The legal status of resale price-maintenance ~~is still un~~certain.[14] The trend of recent court decisions has, nevertheless, made three things fairly clear. The ~~manufacturer who~~ sells his goods outright thereby loses control over ~~them~~. Although he may suggest prices to dealers he cannot enforce their maintenance, for contracts which bind

sole purpose the destruction of competition and the fixing of prices, are injurious to the public interest and void." Decision of the Supreme Court of the United States in the case of the Dr. Miles Medical Company *v.* John D. Park and Sons Company, April 3, 1911. 220 U. S. 408.

[12] The U. S. Supreme Court decided this in the case of the Federal Trade Commission *v.* the Beech-Nut Packing Co. (Jan. 3, 1922), 66 U. S. (Lawyers' Edition) 178.

[13] In the case of the U. S. *v.* Colgate and Co., 250 U. S. 300, and in the case of the Great Atlantic and Pacific Tea Co. *v.* The Cream of Wheat Co., 227 F. R. 46, the courts affirmed the right of vendors to select their bona fide customers, under the common law and section 2 of the Clayton Anti-Trust Act. See also S. H. Slichter, "The Cream of Wheat Case," *Quarterly Journal of Economics,* Vol. XXXI (1916), pp. 392-412. The situation is not clear in all cases, however. See the Federal Trade Commission *v.* Beech-Nut Packing Co. (Jan. 3, 1922), 66 U. S. (Lawyers' Edition) 178.

[14] For detailed discussions of the legal status, and for citations to important cases, see Tosdal, *op. cit.,* pp. 35 ff; C. T. Murchison, "Resale Price Maintenance," Columbia University, *Studies in History, Economics and Public Law,* Vol. LXXXII (1919); and the annual reports of the Federal Trade Commission. *Printers' Ink* follows current developments and one of the most recent discussions of the trend of court decisions is that of W. H. Spence, "Recent Cases in Price Maintenance," *Journal of Political Economy,* Vol. XXX (April, 1922), pp. 189-200.

the dealers to such prices cannot be enforced B) A manufacturer may, however, refuse to sell dealers who do not observe his prices. This may be sufficient for manufacturers who sell directly to retailers, but it is little protection to the great majority who sell consumer goods to jobbers. Again, a manufacturer who consigns goods to dealers and keeps title to them until they are sold to consumers may maintain prices in that way. There are few, however, who care to take the risk involved in such a policy, or who have the financial strength to carry it out.

Because of the uncertain legal situation there has been a rather insistent demand to legalize resale contracts. A few such statutes have been passed by our states, and bills before Congress have received considerable attention. The question is primarily one of economic policy and so the ultimate justification for the practice, and hence, for the passage of such an act, would be the economic benefit that would result to society. With this in mind, let us review some of the more important arguments that have been advanced on both sides of the controversy.[15]

The problem can be best approached by a general discussion of the main arguments for and against the fixing of resale prices by the manufacturer, followed by a discussion from the point of view of the middleman and consumer.

The question is, fundamentally, whether the manufacturer,

[15] The main features of the Stevens Bill as summarized by Murchison, *op. cit.*, p. 29, are as follows:

"I. In any contract for the sale of trade-marked or branded goods the manufacturer may require the observance by dealers of a fixed price, . . . provided that his brand or trade-mark is registered with the Federal Trade Commission . . . [and] that such contract permits a limited number of seasonal or disposal sales—two a year—in case the manufacturer does not choose to repurchase the goods himself on thirty days' notice.

"II. Emergency circumstances such as bankruptcies, fires, deterioration of goods, etc., may justify a divergence from price, provided the manufacturer after thirty days' notice does not care to repurchase the stock."

whether a manufacturer

who sells an article identified by patent, copyright, or trade-mark—for which he has created a consumer good will through his own sales efforts—is justified in dictating the prices at which that article shall be disposed of after it has left his hands, and is being sold by independent jobbers and retailers; or is each of these dealers entitled to decide for himself, at what price he will sell the product?

Arguments Concerning Price-Maintenance: (1) The Manufacturer.—The advocates of price-maintenance hold that it is unfair, after a manufacturer has built up his business through advertising and other means of demand creation, for a few dealers to make an "unfair" use of the good will thus created for the product, to the detriment of competing dealers and eventually to that of the manufacturer himself. It is held that price-cutting tends to cripple this good will, by causing ill will, or lack of interest, on the part of other dealers. Sales are then curtailed or else prices have to be lowered by the manufacturer. And, of less importance, it is argued that good will is undermined because the value of the product is lowered in the eyes of the consumer.

The first point is the important consideration. That price-cutting operates toward disorganizing a market can be acknowledged without admitting the dire results which are said to follow, or the need of the remedy which is proposed. The lack of supporting data concerning the evils of price-cutting of this sort places the burden of proof on those contending for price-maintenance, and their *a priori* reasoning concerning the evil effects of price-cutting avails little in the absence of such evidence. Thus, although a majority report of a committee of the Chamber of Commerce of the United States related that they knew of "literally hundreds" of cases of damage to the interests of manufacturers and merchants, facts to support their contention were not given. The minority report declared that its members had been "unable to ascertain one well defined case of the failure of either a manufacturer, jobber, or retailer resulting from price cutting on identified

goods."[16] Professor Tosdal states that an examination of the statistics of failure in the United States shows that they do not offer much support to the contention that great evil results from the practice.

Extreme price-cutting always tends to lower profits whether the goods be branded or unbranded, but it might seem that the advertised branded article of real merit would have a sufficient hold on the market to maintain its position, even though it does offer an excellent mark for the price-cutter. The nature of this argument is rather interesting, in view of the fact that the lowering of the price of an article usually leads to an increase in the volume of sales. That the consumer demand for some goods is likely to decline if the price is lowered may in rare instances be true. That is, consumers may question its value at the low price, or "high class" consumers may no longer care to purchase it. But the far more general result of a lowered price is to increase the volume of sales, in which case the demand for the manufacturer's product will grow rather than decline. But in the case under consideration the situation is different. For when the price is lowered by a single dealer in a market, or by a minority of dealers, it is held that a different result follows. True, the price-cutters may sell more individually. But the fall of the article in the esteem of the consumer, or, more particularly the disinclination of other merchants to push its sale, may more than offset the increased sales in the cut-price stores. But may not the importance of these points be greatly overemphasized? For surely, if a large consumer demand has been created for an article this can be expected to offset to a large degree any disinclination of the dealer to handle it. And few consumers will lose their desire for an article simply because the price has been lowered. It is also true that for many products consumers will not take the trouble to shop

[16] See *Report of the Chamber of Commerce of the United States on Maintenance of Resale Prices,* Referendum No. 13 (April 1, 1916), pp. 14, 21, but see also C. T. Murchison, *op. cit.,* pp. 32 ff.

about. Even when they know that a given article is sold more cheaply at another store they will not usually, unless the difference in price is very great, go much out of their way to make the saving. favor Price maintenance

The Manufacturer's Status.—If the manufacturer has created a powerful consumer demand for his product he need not fear price-cutting of this sort, for retailers will have to handle his product or lose trade. But, even though this is true, he may lose the assistance of the dealer in supplementing his own demand creative activity. And in reality very few manufacturers have been able to create so insistent a demand as this. The majority of people when asking for a specified article are willing to take a substitute, either because of the trouble of looking further, or because of the power which the retailer can exercise in the sale. As is sometimes said, consumer "acceptance" has been created, not consumer "demand." Again, if the product is a necessity of which the manufacturer has a virtual monopoly he need not fear, for the product will be demanded of the retailer just as in the previous case, save only that the demand may be more insistent, since no substitutes are available.

But most manufacturers are not protected in these ways. And they feel that they cannot ignore the problem. Even those who are protected do not get the full value of their sales efforts if the antagonism of the dealers who handle the goods has been aroused because their competitors cut the price; or even if the dealers simply are not interested in pushing them. Many manufacturers, when they fear that price-cutting will injure their business, contend that they can continue to reap the benefits of their market campaign only by fixing the resale price of the goods. They feel that in this way alone can they eliminate the price-cutter as a disorganizing influence.

For the manufacturer large enough to establish his own channels of distribution or even to do his own jobbing, it is relatively easy to do this. In the first case, he can set the

price at which he himself sells the consumer. In the second, he can refuse to sell those retailers who will not maintain the prices he stipulates. For although the legal status of a manufacturer who refuses to sell directly to a price-cutter is uncertain, it would seem that in general he will have little trouble.[17] But for the small manufacturer, or the manufacturer of a single line, this method of maintaining prices is likely to be impossible. He cannot afford the expense involved in having a sales organization of his own, nor is he likely to be willing to bear all the risk incident to such a plan of distribution. For him, a gentlemen's agreement or a contract, if legal and enforceable, might possibly be efficacious in controlling the resale price among the jobbers, particularly if they are few in number. But for the retail trade, a gentlemen's agreement covering a wide area is not feasible. In such a case, apparently, only a contract enforceable at law, or the close coöperation of jobbers in exacting compliance from retailers, will assure the maintenance of prices.

(2) Price-Maintenance and the Middleman.—Fundamentally, the fate of a policy of maintaining prices by means of a contract should rest upon the economic aspects of the question as viewed from the standpoint of the final consumer. But the effect on the merchant, as well as on the manufacturer and consumer, is also important. In fact, it is the effect of price-maintenance on manufacturers and merchants and on their sales policies which will determine the effect on the consumer. The attitude of jobbers consequently warrants a word.[18] In so far as they handle their own competing brands they tend to favor price-maintenance, but since prices may be easily maintained in sales to the first purchaser there is little need for a statute to protect their own branded goods. Consequently, the jobber's chief interest in the prob-

[17] Murchison, *op. cit.*, pp. 27–28, and cases cited on p. 452, notes 12 and 13.

[18] Jobbers have not taken a prominent part in the discussions of resale price-maintenance. In so far as their associations have acted it has been to favor the policy. But many individual jobbers are opposed.

lem is determined by the effect which price-cutting and prices maintained by manufacturers have upon his retail trade. Thus, if the jobber feels that price-cutting will eliminate small retailers and encourage the development of large retailers, who buy directly from manufacturers or who force him to give price concessions, he will favor a policy of price-maintenance. This would do away, besides, with the demands of some of his customers for low prices to meet the competition of price-cutters. Again, those jobbers in a precarious position in the trade would welcome fixed prices, since such prices would probably carry a sufficient margin for them to operate on. Since the success of the jobber is dependent on the continuance of small retail establishments his interest will be primarily determined by the effect of the policy on that class of stores.

Retail Monopoly Argument.—In the consideration of the price-maintenance problem in its relation to retailing, it has been contended that price-cutting gives to the large retailer a weapon with which he can force smaller competitors from the field. If this is true, fear is expressed that a monopoly will develop on the part of a few great establishments like the mail order houses, department stores, and chain store systems. The data at hand do not seem, however, to warrant so general a conclusion. Furthermore, the legalization of price-maintenance, unless the policy were widely adopted, would not hinder this process. For cut prices on other articles, such as staple but unbranded merchandise or on merchandise branded by the merchant, even now used often as "leaders," would have the same general effect. Or if prices were maintained on all articles sold, competition would simply be forced from the field of price into that of service where the more efficient and more powerful merchandisers could continue to reap advantages. The result, then, would be unsatisfactory to the consumer, for now he can choose between the different types of stores. He can buy of the stores offering low prices

and fewer services, such as the familiar cash-and-carry grocery store, or he can buy from stores charging higher prices but offering greater services. With generally maintained prices he would have to pay for these services whether he wished or no. The inefficient stores would still be at a disadvantage, and small but efficient stores at no greater advantage in competing with larger competitors than they are now. One of the essential tests of modern retail efficiency is the rate of turnover, and an important method of stimulating turnover is through lowered prices. It is evident, then, that to the extent that price-maintenance would keep prices higher than they would otherwise be, either retailing would by so much be less efficient or else other means would have to be developed to speed up the turnover. Finally, the fear of monopoly seems absurd. Even though all small stores were eliminated, present indications are that the competition between great department stores, chain store systems, coöperative stores, and mail order houses would continue unabated.[19]

(3) **Price-Maintenance and the Public.**—On the assumption that price-cutting tends seriously to injure the market of the manufacturer of advertised, branded products, it is argued that maintained prices are not in the interest of the manufacturer and of the middlemen, alone, but of the public as well. Two reasons are advanced. In the first place, it is held that such products are produced and sold by superior methods, which assure the consumer a uniform product of superior quality and enable him to make his purchases with greater ease and certainty.[20] In the second place, it is argued that price-maintenance is a problem which arises in the case of advertised, branded products; that these products are commonly superior products; and that the sales efforts of the manufacturer lower their cost through enlarging the market

[19] For a discussion of the present strength of the small unit store, see pp. 187–190.

[20] This has already been discussed in Chap. XIX.

and thus lowering the expense of both production and distribution.[21] But, this contention runs, cut prices tend to increase the manufacturer's ~~problem of demand creation,~~ to raise the costs thereof, and may even tempt him to lower the quality of his ~~product in order to~~ compete on a price basis rather than on a quality basis. Either result will be unfortunate. On the other hand, it is held that price-maintenance will assure to the public the benefits ~~derived from~~ the sale of branded articles, and all of the savings derived from the manufacturer's superior production and selling, and particularly from his advertising.

This is all a question of fact. Price-maintenance has not been attempted in the case of large numbers of branded products, yet they continue to flourish and to increase in number until the benefits derived therefrom are to some degree counteracted by the mere increase in the number of competing brands. Hence price-maintenance does not seem necessary for keeping what advantages come from the introduction of branded articles. In fact, there is reason to believe that these benefits would not be so great under a régime of price-maintenance as they are now. This is the case because there would be a tendency to increase competing brands, and hence to increase competing advertising. The cost of this might well run up, without any firms gaining such a commanding position as actually to reduce the total cost of demand creation. And if a few firms did gain such an advantage, it seems more than likely that the opportunity to maintain prices would facilitate price understandings which would cause prices to rise. In other words, it would tend to make such an advantage swell the profits of the fortunate manufacturers rather than to reduce the price to consumers. In the absence of such understandings competition or a desire to enlarge the volume of business would, however, undoubtedly lead to price reductions even if the supposed benefits from price-maintenance were realized.

On the other hand, the contention of some opponents of

[21] See pp. 24–27, 396–398, and pp. 522–529.

price-maintenance that competition would be eliminated if price-maintenance were legalized is not sound. Not even price competition is avoided. For although a uniform price of resale is maintained by a manufacturer, that price must be set with a view to the prices of competing goods, the strength of the desire of consumers, and the likelihood of substitution. Dealer competition based on cutting prices is, of course, avoided; for with the standard price set by the manufacturer the competition of dealers must emphasize the quality of the product and the service offered by the dealer—at the fixed standard price. The chief danger to competition would be that competing manufacturers would use price-maintenance as a means of making understandings as to prices more effective. Such understandings exist now, and price-maintenance would change this situation only if it facilitated them. It is not at all clear that this would occur, although the price-fixing activities of some "open price associations" might be facilitated.

The changed emphasis in dealer competition, mentioned in the last paragraph, is the cause for some objection to the policy. The development of "service" as a means of retail selling is considered by many to have gone too far. It is generally supposed to be one important cause for the high cost of retailing. The recent development of "cash" stores and of cash-and-carry stores has been welcomed as a means of affording lower prices to the large number of consumers who are willing to forego service in order to gain lower prices. It seems unreasonable that dealers whose costs are low, either because of reduced service or of greater efficiency, should not be allowed the use of the price appeal, and that consumers should not receive the price advantage which would result.[22]

In the long run it appears inconceivable that a single, maintained retail price can prevail. The different types of service offered by retail stores must in the end be recognized.

[22] There is no question of the existence of differences in costs. See pp. 515–516.

Even this would not give full play to differences in the efficiency of stores offering similar service. Since society depends on competition to force out the inefficient and to force prices toward lower levels, any system which retards that process must offer compensating advantages.

What Does the Dealer Purchase?—It is held that the dealer who purchases an article is entitled to resell it at any price he desires.[23] On the other hand, those who favor price-maintenance argue that although the article is the dealer's, the ease with which such goods are sold depends, after all, on the good will which the manufacturer has created for them at his own expense. But the opponents of price-maintenance contend that the dealer is paying for this good will when he buys the article: in fact, that this good will is even used as a sales argument, or as a club over his head, in selling him. The risk of the destruction of that good will the manufacturer can well afford to take, they assert, if the benefits derived from it are as great as they are held to be. On this point, however, it has been shown that few facts have been marshalled to show that such good will is actually destroyed.

Price-Maintenance and Efficiency.—Whereas the advocates of price-maintenance sometimes hold that price-cutting tends to eliminate the small merchant, and to foster monopoly on the part of a few large merchandisers, their opponents contend that price-maintenance penalizes efficient merchants and is disadvantageous to the public because it limits competition on a price basis. This tends to keep the public from benefiting from superior merchandising ability, because the efficient dealer is forced to compete on a basis of service alone. And it appears that perhaps the inefficient merchants would be assisted to continue in business, and thus the superior merchandising ability of the more efficient would result in greater profits to them and not in lowered prices to the consumer.

Again, it is argued that fixed prices will tend to be high-

[23] The same reasoning does not apply when goods are consigned to be sold at a price which the manufacturer stipulates.

prices, as the avowed purpose is to maintain prices which will make possible a higher profit to manufacturer, jobber, and retailer. But this contention does not appear to be entirely warranted. A compilation quoted by Cherington [24] seems to indicate that the retail margins on some price-maintained articles are higher, and on some lower, than those on similar articles on which prices are not maintained. After all, the maintained price, in the absence of monopoly, must be set with a view to the prices of competing products, and can be no higher than the market will warrant. Maintained prices do not necessarily mean high prices; they tend rather to place all dealers on the same price basis, high or low as the case may be. In the absence of severe competition, however, the price would undoubtedly tend to be fixed at a price which would enable all dealers, except the very poorest, to make a profit. This would be true, unless the manufacturer believed that the more rapid turnover of efficient distributors, selling at a low price, would offset the loss of sales by the less efficient dealers who could not sell at that price.

The Manufacturer's Dilemma.—This last point suggests the dilemma which the manufacturer faces. It has been shown that when a few dealers cut prices other dealers become dissatisfied. To meet their demands the manufacturer must either lower his prices so that these dealers can compete with the price-cutter, or he must fix the resale price and enforce its maintenance. If he does the former the way is thereby opened for a still further cut by the price-cutter, and unless an enlarged volume of business results to offset the new price he makes to his distributors, the manufacturer must suffer a reduction in profits. But if he does the latter, i.e., fixes resale prices, he may lose the trade of the price-cutting merchant. At best, any increase in the volume of business in the price-cutting stores which resulted from their low prices will be cut off. These dealers, however, are often an important outlet for the

[24] In his *Advertising as a Business Force*, pp. 386–390, from the June 27, 1912, *Printers' Ink*, p. 3.

manufacturer's goods, so that he desires to retain their good will. This is particularly true of lines in which chain stores are important, for these stores frequently operate on a cut-price basis, and they do a considerable part of the whole business in some lines, such as groceries and drugs. The manufacturer wants the business of the large price-cutters, and if their business becomes especially desirable his attitude toward fixing resale prices may undergo a change. This may, if the large price-cutting merchandisers continue to grow in importance, force the manufacturer to distinguish between "service" and "non-service" stores, and between large and small stores, in adopting a policy with regard to prices.[25]

Conclusion.—In conclusion, it seems that the evil results from cutting the prices of branded goods are perhaps not so 1) great as the advocates of price-maintenance believe. Furthermore, where such evils do exist it would seem that an 2 administrative agency, such as the Federal Trade Commission, could restrain the price-cutter.[26] It is a grave question whether the public would benefit sufficiently from legalized price-maintenance to warrant such interference with the established régime as would probably result.[27] But in this connection it should be said that even with price-maintenance legalized, stable prices could not be maintained long in the sale of most products. Changes in production and distribu-

[25] Many manufacturers and jobbers give lower prices to large stores—quantity discounts which smaller stores cannot obtain because the volume of business does not warrant it.

[26] Section 5 of the Federal Trade Commission Law declares unfair methods of competition illegal and allows the Commission to decide what is unfair. The Commission is now opposed to price-maintenance, holding it to be an unfair method of competition in violation of Section 5 of the Federal Trade Commission Act. In a number of cases the Commission has issued orders to cease the practice. With the decision in the Beech-Nut Packing case the Commission's stand on many of these cases has been upheld by the courts.

[27] On the other hand price-maintenance was not thought to be illegal until the case of Miles *v.* Park, 220 U. S. 373, was decided in 1911, and the decisions in other cases were handed down about that time.

tion constantly lead to price changes. And prices would be particularly hard to maintain in a time of falling prices. Finally, it may well be doubted whether those who maintained prices would really benefit in the end, since competition would not be eliminated but would turn to competition in service and quality, which might ultimately bring about conditions as bad.

There is, nevertheless, room to question whether a manufacturer should not be allowed this privilege if he desires it. The manufacturer who sells "direct" to retailer or consumer can legally maintain prices if he wishes. But the manufacturer who has insufficient capital to sell directly, or who believes it is more economical to use jobbers, finds it difficult to dictate selling prices. In the event, then, that such a manufacturer believes price-maintenance is important he has an incentive to market through his own organization. He may even choose to do so despite the added cost. This would seem to be unfortunate for him and for society. But if the manufacturer who markets directly to retailer or consumer can maintain prices there is good reason to argue that his smaller competitor, and manufacturers in other lines in which direct marketing is not feasible, should be allowed to exercise the same privilege.

Perhaps the whole controversy has assumed unwarranted importance. Doubt has already been expressed as to its importance to manufacturers. On the other hand, it is a question as to whether legalized price-maintenance would have much effect on the consumer. With competing products, price competition would simply be shifted from the retailer to the manufacturer. Since the manufacturer would have to feel the pulse of the market to maintain his sales, the consumer would not suffer. If the industry were monopolized, or if the maintained prices took the form of understood prices, as between competitors, nothing fundamentally new would be introduced. Legal remedies are at hand to deal with such contingencies, and if price-maintenance facilitated such under-

standings, a requirement—such as that of the Stevens Bill—that prices be registered with the Federal Trade Commission, would be sufficient protection from this new danger.

II. Unfair Competition

Introduction: Competition and Economic Effectiveness.—To achieve the best economic results, competition must be so ordered that those individuals, firms, and corporations which are most efficient in making and selling will survive the struggle with their less efficient competitors. This does not mean that it is to the interest of society that the largest, the wealthiest, or the most unscrupulous should succeed, but rather, that he who produces the best product at the lowest cost, or who can market the products of others most effectively and most economically should succeed. In this way competition tends toward the survival of those producers and middlemen who can best serve society, and through them, to the development and perpetuation of the best technique. Unfortunately, however, the profit seeking which underlies the competitive system often leads to methods of competition which, however effective they may be from individual points of view, cannot be said to be to the best interest of society. Such methods,—i.e., methods which tend to the survival of those who use them, but which do not tend to promote more efficient production and distribution—are coming to be called unfair methods of competition. They are looked upon as unfair to competitors, and as economically and socially undesirable.

Unfair Methods and Big Business.—The unfair methods of competition which have received widest publicity have been closely associated in the public mind with the methods of big business. And indeed, they are frequently methods which can be used effectively only by firms, or combinations of firms, which are larger and more powerful than their competitors, though not necessarily technically superior to them. These methods are various, and the literature of the relations of big business with the courts abounds in examples. Some

of the more important of these unfair methods of competition will now be presented in order to give a general picture of the practices involved. It will be evident, however, that many of them are not always "unfair." In fact, some of them are commonly looked upon as legitimate means of competition.[28]

I. **Unfair Price Practices.**[29]—First in importance are certain practices which center largely about prices. It is expected that competition will center about price, and conse-

[28] In its efforts to enforce Section 5 of the Federal Trade Commission Act "the Commission has handled some 3,000 cases, has issued 788 formal complaints, and issued 480 orders." Most of these cases have been brought to the attention of the Commission by business men themselves "and they indicate the presence of a strong and healthy force in American business life tending toward the suppression of obstructive elements and the upbuilding of fair and moral commercial standards."

Two general classes of cases come before the Commission: "first, those practices where a difference of opinion as to right and wrong exists in the trade itself. Such questions are highly controversial. They include and are typified in the question of resale-price maintenance. . . .

"Second, those practices where a difference as to right and wrong does not exist in the trade itself, but where in given cases there is controversy over the facts."—*Annual Report of the Federal Trade Commission* (1921), pp. 5–7.

A list of the "methods of competition condemned" will be found in the annual report for 1920, pp. 56–57.

[29] The Federal Trade Commission has classified the methods of unfair competition "violative of the statute" into three broad classes:

"(1) Methods involving an element of moral turpitude since they are characterized by fraud, deception, misrepresentation, intimidation, or some similar wrongful element.

"(2) Methods which while not generally involving any element so clearly violative of good morals, are, nevertheless such as are unlawful because condemned by the common law.

"(3) Methods not involving either of the elements in the foregoing classes but which had the effect of directly placing restraint upon the freedom of particular competitors to compete, of closing the channels of distribution by contract or otherwise to competitors generally, or of eliminating competition or otherwise restraining trade to the detriment of competitors and the public."—*Annual Report,* 1920, p. 48.

quently it is illuminating to see in what ways such competition may become unfair.[30] (1) First of all is the plain policy of reducing the price of products below the cost of production. Obviously, if a price were reduced below a competitor's cost of production but still allowed a reasonable profit to the price-cutter, that would be the very result which it is hoped to obtain through competition. The less efficient producer would thereby be eliminated. But when the price-cutter lowers his price below his own cost of production, an entirely different situation arises. A practice of that kind can be carried to a successful conclusion only by a firm which is financially more powerful than its competitors, and even then for but a short time or in part of its market. A firm financially weaker than its competitors would be playing a losing game, whereas in the case of firms of equal financial capacity and productive ability the policy would result in a victory for neither. But the financially powerful organization may be less efficient than many of its financially weaker competitors, and yet through mere "length of purse" it may be able to cut prices until its competitors are ruined,[31] or are willing to compromise on some basis that is more agreeable to the stronger party than it would be to carry the struggle through.[32]

Other Price-Cutting Methods.—But price-cutting may not be so widespread. (2) A large organization may wish to eliminate a competitor in a certain section of the market. By lowering prices there and keeping them up elsewhere it will bring about the desired result effectively and more cheaply.

[30] The fixing of resale prices is considered undesirable by the Federal Trade Commission, but that practice has already been considered.

[31] F. W. Taussig, *Principles of Economics*, Vol. II (rev. ed., 1915), p. 427.

[32] Illustrations are not used in the present discussion. They are easy to find, and those interested are referred to the Bureau of Corporations, *Trust Laws and Unfair Competition* (1915), and its reports on the steel and other industries; W. H. S. Stevens, *Unfair Competition* (1917); *Annual Reports of the Federal Trade Commission*, and the great volume of "trust" literature now available.

(3) Or the manufacturer of a "line" of products may be able to undersell the competitor who produces a single commodity in that line by reducing prices for it below costs. Although losing money on the one line he can still sell the other products at the usual prices. Sometimes the same object is accomplished more indirectly, and (4) supposedly independent companies controlled by the price-cutter offer their product at a low price while the product of the parent company continues to be sold at the regular prices. These "bogus independents" prove to be effective in destroying competition while at the same time regular prices and the good will are retained for the parent company's product. (5) In still other cases the company may put out a single product—a "fighting brand"—of approximately the same characteristics as the competing product. By doing this it hopes to gain the trade of those handling the competing brand. At the same time, it continues to sell the regular lines at the usual prices.

Some other methods of competition found in the trade activities of merchandisers, as well as in those of manufacturers, can also be grouped under the head of price-cutting methods, although they affect prices more indirectly. Thus (6) some manufacturers and some retailers use trading stamps, coupons, and the like, so that when a certain amount of business has been done a prize of some sort is received. It is obvious that this is in the nature of an indirect discount for quantity purchases, which may or may not be unfair as it results or does not result in unduly lowering prices. It has sometimes been used as a means of local price-cutting. When used by manufacturers a scheme of this kind is made even more effective by giving the discount only in case all products of a given line are bought from the manufacturer. (7) Sometimes large quantity discounts, or "inside prices" are used to undersell competitors.[33] These may be granted only to very large buyers, and in so far as they are not warranted through the savings that may result from handling large orders, they

[33] See P. H. Nystrom, *The Economics of Retailing* (1915), Chap. XVI.

discriminate against competitors. (8) In yet other cases it has been urged that certain manufacturers or dealers give excessive credit or discounts for cash which their competitors who can produce as efficiently cannot give.

II. Closing Channels of Distribution.—A very effective method of destroying competition is to close the channels of trade to a competitor's product. He is then forced to sell his product directly to the ultimate consumer through his own marketing system or else go out of business. Or if he is a dealer, he must produce his own product. Of course this method is seldom so effective as this statement makes it appear to be and it results usually only in hampering the competing firm to a greater or less degree. Among the most common means of closing the channels of distribution to a competitor are the exclusive dealing contract and the method known as "full line forcing." (1) In the former case the manufacturer induces the dealer to whom he sells to agree to handle no competing line. If he is able to get the best dealers in a given area to agree, the most desirable channels of distribution are thereby closed to competitors, who must then distribute their goods themselves or use inferior middlemen. (2) In the second method the seller controls some particularly desirable product which the dealer feels that he must handle to keep his trade. But the seller refuses to allow him to merchandise it unless the dealer also agrees to handle other products which the seller has. Combined with the exclusive dealing contract, such a system operated by a powerful firm may prove very effective in hampering the trade of those who are attempting to sell competing lines.

(3) There is a general feeling of hostility on the part of the retailer and the wholesaler who term themselves "regular" dealers against new types of dealers, and against those who step out of their place in the channel of distribution. Thus, manufacturers who sell over the heads of jobbers or directly to consumers are not looked upon with favor, and likewise "direct" purchase by consumers and dealers is opposed. To

counteract these methods of trading, strong dealer associations, through the use of lists of "regular dealers" and of "fair" or "black" lists of dealers and manufacturers, sometimes attempt either to have manufacturers sell only to "regular" dealers, or to have the regular dealers buy only of the manufacturers or jobbers who are "fair"—in the sense that they do not overstep the bound of their "regular" business, as those bounds are set by the "regular" dealers. These efforts are often very successful in the accomplishment of the dealers' purpose. But as they tend to maintain the *status quo,* they are likely to stand in the way of such integrations in marketing processes as might, if allowed to develop, produce a true economy in marketing.

III. Dishonest and Questionable Practices.—In addition to the methods which have been discussed other practices are engaged in which are obviously dishonest. These practices not only hamper competitors in their market, and so keep them from reaping the natural benefits of such productive and distributive efficiency as they may possess, but most of them can be questioned when viewed from either the ethical or social point of view. Among such practices are (1) attempts to induce a competitor's customers to break contracts and refuse to make purchases or sales of products as agreed;[34] (2) espionage upon another's business through bribery of his employees or of the employees of service industries, such as railroads and express companies who handle his product; (3) bribery of the buying agents of a competitor's prospects; (4) misrepresentation of a competitor's goods through advertising, salesmen, or correspondence; (5) passing off one manufacturer's goods as those of another, by wholesale and retail dealers; (6) bringing unwarranted suits against a competitor for infringement of patents or other alleged illegal acts, so as to injure the competitor and give him a bad name in the trade; (7) copying and selling goods based on the patents of weaker competitors who

[34] They may even agree to protect the contract breaker financially in case of a law suit.

cannot afford a suit at law to protect their rights. (8) Less direct is the use of coercion, or intimidation of a competitor or his customers, through threats to use some of the methods already discussed in case they continue to compete, or to purchase of, or sell to, the competitor, as the case may be. (9) Finally, even such violent methods as the direct interference with competitors have been so prominent as to warrant mention. Breaking a competitor's product in the hands of the purchaser, interference with delivery through bribing transportation companies to delay shipments, or through fomenting strikes, following up salesmen and using forcible methods of hindering sales, and similar crude devices, have been used.

Unfair Competition and the Public: Conclusion.—The practices mentioned in this discussion are practically all of no direct benefit to the public. On the other hand, they hinder the trade of competing firms, and, so far as the injured firms are as efficient or more efficient than the dishonest or unscrupulous competitors, concerns may be eliminated from production and distribution which it would be to the interest of society to retain. These practices show some of the excesses of our competitive régime, which must be curtailed if the best results are to be achieved.

CHAPTER XXIII

THE RELATION OF THE STATE TO MARKETING

I

In the preceding chapters consideration has been given to some of the more important activities of the state which affect marketing. In the present chapter governmental efforts will be further considered, in order to show their objects and their effects upon the distribution of goods. The question of the relation of the state to marketing is the most important part of the broader problem of the relation of the state to industry. Its discussion at this time is peculiarly pertinent. In the United States, as in foreign countries, central, state, and local governments are, more and more, restricting, regulating, investigating, and studying trade and industry. They are also, in increasing degree, supplying aid and information. There is, thus, a trend toward a greater interest of government in business. But with bureaus, commissions, investigation, restriction, and various forms of assistance to industry on the one hand, and with distinct opposition to these efforts on the other, no definite policy has been accepted.

Types of State Effort: Relative Importance.—Existing state activities have been divided into (1) those which are necessary—namely, those functions which must be performed if the existence of government is to be justified; (2) those which are natural, or normal, but not necessary; and (3) those which are neither natural nor necessary, but which are often exercised.[1] Among the "necessary" functions Garner places the maintenance of internal order, peace, and safety, the pro-

[1] J. W. Garner, *Introduction to Political Science* (1910), pp. 318–320.

tection of persons and property, and the maintenance of external security. As natural or normal, but not necessary, he enumerates such efforts as the postal service, the construction and maintenance of dikes, bridges, lighthouses, harbors, and canals, the maintenance of scientific and statistical bureaus, protection of the poor, education, and the regulation of trades and of business. These services are important to the public welfare, and they would be unprofitable or impossible of performance by private enterprise. Among those which are considered to be neither natural nor necessary but frequently undertaken are the construction, operation, and maintenance of railways, telegraph and telephone lines, gas and electric plants, and waterworks; the encouragement of industries by bounties, tariffs, and subsidies; and loans to farmers, railroads, and industrial concerns.

The Conflict of Interests.—The ~~most~~ extreme opponents of governmental interference in business seldom contend ~~that~~ ~~efforts of~~ the first kind are unjustified. And the great majority of ~~people agree that the~~ performance of the second group of activities, and in a less degree even those of the third, is a desirable function of government. This is true except perhaps when such acts interfere with private interests. For example, when a bounty or tariff protecting a particular industry is advocated, those who would benefit from the proposed program are likely to support that special policy. But these very interests may fight bitterly against any effort to "control" the profits of their business, to establish a minimum wage for their employees, or to enforce requirements looking to the diminution of the evil results of adulteration.

In England and the United States, where the theory that the state should let business alone is most strongly advocated, government activity has nevertheless extended into each of the three fields which have been mentioned. This was true even before the World War. During the war, government control developed rapidly and to a great extent that tendency persists. There are signs that seem to point to a reaction, but

it appears to be more likely that the events of the World War caused a permanent increase in the exercise of government control over business.

It is interesting to consider the degree to which various interests turn to the government for assistance in carrying out particular reforms or for special assistance and privileges. The President is asked to bring pressure to bear to prevent a railway strike; and the Secretary of Commerce is named as one who should be called upon to settle a proposed coal strike. State legislatures are asked to pass laws to prevent the increase of rents. The Adamson Eight-Hour Law is forced through Congress by railroad labor and the Transportation Act of 1920 is forced through by railroad investors. Agricultural interests try to have legislation passed which will abolish produce exchanges, and succeed in having one law enacted which gives a certain degree of control over the exchanges to the Secretary of Agriculture and another which gives him supervision over the stock yards. Manufacturers endeavor to have a protective tariff established and American shipping interests are insistent in demanding a ship subsidy, freedom from paying tolls for the use of the Panama Canal, and the repeal or amendment of the Seamen's Act.

Two Opposing Views of Governmental Regulation.[2]—

[2] There is a short, well selected collection of references on the relation of government to industrial activity in L. C. Marshall, *Readings in Industrial Society*, pp. 1019–1082. See also W. S. McKechnie, *The State and the Individual* (1896); R. G. Tugwell, "Economic Basis for Business Regulation," *American Economic Review*, Vol. XI, No. 4 (Dec., 1921), pp. 643–658; Adam Smith, *Wealth of Nations;* J. W. Garner, *Introduction to Political Science;* H. C. Adams, "An Interpretation of the Social Movements of Our Times," *International Journal of Ethics*, Vol. II (Oct., 1891), pp. 32–50, and his "Relation of the State to Industry," *Publications of the American Economic Association*, Vol. I (1887), pp. 465–549; C. R. Van Hise, *Concentration and Control;* S. P. Orth, *The Relation of Government to Property and Industry;* J. T. Young, *The New American Government and Its Work;* Annual Reports of the Federal Trade Commission and of other government bodies; R. T. Ely, *Socialism and Social Reform*, and *French and German Socialism;*

There are two contrasting points of view concerning the procedure by which a government, in its relations to business, can best promote the public interest. At one extreme is the view that there should be no interference with business in any ~~way.~~ This attitude rests on ~~the assumption~~ that, although individuals when unhampered by the government will seek their own selfish interest, this interest will in the long run make them act in ways that will prove advantageous to all. At the other extreme is the view that the state should closely regulate and control business, and even that it should own and operate industries.

Laissez faire.—The first point of view, the *laissez faire* policy, if carried to an extreme, would mean the absence of all governmental regulation or assistance of business. This view is seldom held. A more moderate view was expressed by Adam Smith in the third quarter of the eighteenth century:

> "All systems either of preference or restraint, therefore, being thus taken away, the obvious and simple system of natural liberty establishes itself of its own accord. Every man, as long as he does not violate the laws of justice, is left perfectly free to pursue his own interest in his own way, and to bring both his industry and capital into competition with those of any other man, or order of men. The sovereign is completely discharged from a duty, in the attempting to perform which he must always be exposed to innumerable delusions, and for the proper performance of which no human wisdom or knowledge could ever be sufficient; the duty of superintending the industry of private people, and of directing it towards the employments most suitable to the interest of society."[3]

This view leaves to government only the protection of society from violence, injustice, and oppression, and the performance of certain necessary public works which could not be profitably developed by private firms.

In contrast to Smith's view were the conditions actually ex-

John Rae, *Contemporary Socialism;* O. D. Skelton, *Socialism: A Critical Analysis;* John Spargo, *Syndicalism, Industrial Unionism, and Socialism;* C. E. Merriam, *American Political Ideals.*

[3] *Wealth of Nations,* Book IV, Chap. IX (Cannan's edition), p. 184.

isting just previous to his time, conditions against which he was protesting. Thus in marketing alone,

> "In England, formerly, practically all combinations and almost all of the modern forms of commercial organization were unlawful. The business of the middleman was unlawful; the business of the modern wholesale grocer was unlawful. It was a criminal offense to buy food or victuals which were on their way to the market for the purpose of reselling them, or to buy, for purpose of resale, large quantities of goods at any time."[4]

Extreme Interference.—At the other extreme from the *laissez faire* policy are proposals for extensive state interference and activity in the realm of business. Opposite ends prompt the advocacy of this view. There are some who believe that only by the development of extreme forms of governmental control can business effort promote the greatest individual welfare. It is argued that individualism without government control causes business operations to be guided into channels which are not in the interest of the great body of the people, either collectively or as individuals. This seems to be the view of many socialists, as well as of many who are more moderate. Others who favor an extreme control of business by the government, desire it, not in the interests of individuals as such, but because they believe that the state as an abstract concept, or as the private interest of a ruling group, can in this way best be fostered.

II

The Relations of Government to Business.—In practice, both points of view—the *laissez faire* policy and the policy of extreme supervision of business affairs—exercise an influence on the everyday evolution and functioning of governments. And regardless of particular theories concerning their desirability, the governmental activities which affect business are now numerous.

[4] A. A. Bruce, "Laissez Faire and the Supreme Court of the United States," *The Green Bag,* Vol. XX (1908), p. 553.

(1) Some of these activities are primarily *negative* in their immediate effects. Their purpose is to prevent actions which are contrary to the public interest—such as the prevention of adulteration and fraud, the curbing of monopoly and restraint of trade, and the elimination of unfair competition. Specific examples are found in pure food laws, in the anti-trust acts, in certain sections of the Clayton Anti-Trust Act and of the Federal Trade Commission Act, as well as in a large body of common law doctrine. The Sherman Anti-Trust Act, for example, declares that

> "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations, is hereby declared to be illegal. . . .
>
> "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any person or persons, to monopolize any part of the trade or commerce among the several states, or with foreign nations, shall be deemed guilty of a misdemeanor. ... ."

Sections 2 and 5 of the Clayton Anti-Trust Act also deal with marketing topics. The provisions are in the spirit of those of the Sherman Act but are more specific. Thus in Section 2 it is declared,

> "That it shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly, to discriminate in price between different purchasers of commodities, . . . where the effect of such discrimination may be to substantially lessen competition or tend to create a monopoly in any line of commerce."

Section 5 of the Federal Trade Commission Act states,

> "that unfair methods of competition in commerce are hereby declared unlawful.
>
> "The Commission is hereby empowered and directed to prevent persons, partnerships, or corporations, except banks [which are otherwise controlled], and common carriers subject to the acts to regulate commerce, from using unfair methods of competition in commerce."

(2) Then there is what may be called "*promotive*" intervention,[5] such as the enforcement of contracts, the enactment of laws which promote the formation of corporations and coöperative associations, and legal provisions for the limitation of liability on the part of certain classes of investors. Of as great importance as these, and fundamental to all efficient marketing, are the promotion and assistance of transportation —financial aid to shipping companies,[6] the exercise of the right of eminent domain to obtain rights of way for railroads and for opening new highways. Other important promotive efforts are the establishment of standard commodity grades, standard containers, and standard bills of lading and warehouse receipts, the law of sales, contracts, and the like. Of less importance, but of great usefulness, are the investigations of methods of marketing, and information and advice for those who are interested in marketing. The market news service of the Department of Agriculture and the trade promotion work of the Department of Commerce are further examples.[7]

(3) Finally, there are what are called "*mandatory*" acts of government, because of their positive compulsory nature.[8] Public utilities are compelled, to some extent regardless of the financial results to them, to charge only a reasonable price for their services—which is positively or negatively determined by administrative officials or legislatures—to treat all customers of a class alike, to serve all who will pay, to buy essential equipment, and to extend service when and where the public interest appears to governing officials to require it.[9]

[5] See H. E. Oliphant, "Legal Intervention in Business," in L. C. Marshall, *Readings in Industrial Society*, pp. 1015–1018.

[6] The desirabality of such assistance is, of course, questioned by many people.

[7] See Chap. XVIII for a discussion of market news.

[8] H. E. Oliphant, *op. cit.*

[9] The acts of legislatures and administrative officers are, of course, subject to review by the courts. See J. T. Young, *The New American Government and Its Work*, Chaps. XV, XXIII; C. A. Beard, *American Government and Politics*, Chaps. XV, XXVI.

The marking of the content of certain foods and drugs on containers, as directed by the Pure Food and Drug Act, and the marking of the net contents of packaged goods on the package, are further examples. Finally, there has been considerable agitation in recent years for such things as the compulsory sale of products held for resale,[10] and the marking on containers of the prices at which producers sell.

III

The government activities which bear directly on marketing can be conveniently divided into three classes:[11] (1) those which are intended to elevate the plane of competition; (2) those which aim to control monopoly; and (3) those which are planned to promote the technical efficiency of marketing.[12]

[10] President Wilson included this suggestion in a message to Congress, Dec. 2, 1919. See *Congressional Record,* Vol. 59, p. 30.

[11] The first two parts of this classification were suggested by the articles of H. C. Adams mentioned in note 2, p. 475.

[12] Governmental action which is of direct importance to marketing can also be classified as affecting price, service, or quality. That is, we can base a classification on the effect that governmental activity has upon the three important measures which the consumer places on the market functionaries and the three important types of "selling point" which are used in the creation of demand. The following table is suggestive of this classification:

OUTLINE OF GOVERNMENT ACTIVITIES: BASIS OF SELLING ARGUMENT

1. Acts affecting prices
   - Price-fixing and rationing
   - Control of transportation rates
   - Inspection and grading
   - Food and drug control
   - Taxes
   - Acts affecting quantity—control of weights and measures
2. Acts affecting service
   - Enforcement of contracts
   - Control of transportation and storage facilities
   - Inspection and grading
   - Licensing business houses
   - Control of commission men of the agricultural market

(1) **Efforts to Elevate the Plane of Competition.**—The first group, comprising those efforts which are designed to elevate the plane of competition, purposes to retain the benefits which result from competition, and yet to exclude those manifestations of competition which seem to thwart the best interests of society.[13] There is no unanimity of opinion as to what forms of control the government should utilize in doing this, and there is no agreement as to just what constitute undesirable forms of competition. There is even no agreement as to the meaning of competition. To some, it implies the absence of all governmental interference in business, a clear field and no favors, with the "survival of the fittest." But under modern conditions a policy of this kind has frequently resulted in domination by the most powerful firms and combinations or by the least scrupulous competitors.[14] These are not, necessarily, those industrially and commercially most fit to survive, and so the interests of the general public are thought to suffer under these conditions. A good deal of state supervision of business, consequently, is necessary even to preserve the "benefits of competition."[15]

Although there is no general agreement as to just what forms of competition ought to be eliminated—in the sense that, in the long run, they are against public interest, as well as against the interests of particular competitors or consumers who are immediately concerned—there can be little question of the general principle involved. The reason for governmental interference rests primarily on the fact that these practices, when undesirable, cannot be effectively prevented by the aggrieved party—at least not without recourse to simi-

3. Activities affecting quality
   Pure food and drug acts
   Establishment of standards
   Laws against fraud and adulteration of products.

[13] Some of these forms of competition were described on pp. 466–472.

[14] Some illustrations of this point were described on pp. 466–471.

[15] The "benefits of competition" are reviewed on pp. 500–501.

lar acts, leading to further reprisals. They can be done away with, consequently, only by associative action or by means of governmental interference.

The Efforts of Associations.—Much has been done by associations of business men to prevent unfair competition. But membership in these is voluntary, and the members of the trade who use unfair methods may be the very ones who refuse to join an association or to be bound by its rules. In case they do join, they may exert their influence against wholesome regulations. Again, after regulations have been adopted they remain to be enforced. This may be impossible without the compelling force of the government.[16] Furthermore, trade associations are slow to develop regulations governing customs which are of primary interest to those outside the trade. The only redress for these is to go to court—a slow and costly process—to form associations of their own to combat these evils, or to "get a law passed" or an administrative agency established to protect their interests. This failure of the business men of a particular trade to meet the demand of outside interests for the correction of abuses often leads, consequently, to a resort to politics. Appeals are made to the legislature for aid, or politicians make the case of the aggrieved party their own. Then the legislature starts out to do what the trade itself should have done. Legislative action of this kind is, furthermore, often unwise, and frequently imposes onerous and unnecessary burdens on business.

[16] This is sometimes done, as when courts enforce decisions made by committees of produce exchanges in settling disputes between members, or even between members and non-members—when the latter have agreed to abide by the committees' decisions. The Chicago Association of Commerce is now using a scheme in which an impartial third party, hired by the Association, adjudicates business disputes. This plan is being adopted by other associations of business men, and the Chamber of Commerce of the United States of America has recently started the machinery for adjudicating disputes between parties in different localities.

When business men engage in fighting these bills, or in contesting unwise laws already passed, the general public receives an unfavorable impression of their attitude toward the public interest. It is an interesting commentary on the short-sightedness or innate selfishness of business interests that they so often appear to be fighting legislation, which was designed to meet generally recognized evils, rather than assisting in the solution of those problems. Large numbers of business men persist in practices, condemned by the public, and often by other business men, long after the obnoxious acts have been forcibly called to their attention. Yet, they should know that, in the end, legislation designed to prevent these acts is almost certain to be passed. And even though it is not passed, the airing of business practices, by prejudiced persons and by politicians, gives to the whole trade a reputation which is based upon the unfair methods of a few. It is even common for practices long since suppressed to be brought again before the public. Much of the present day sympathy with legislation designed to regulate the packers, the railroads, and produce exchanges, arises from the memory of practices long cast aside. The short-sightedness of the building trades in some of the larger cities at the present time is likely to react to their disadvantage for years—whether or not they reform their habits and whether or not the indictments now standing are proved. The inability of the railroads to deal with the rebate evil; the failure of the railroads, terminal elevators, and grain exchanges to solve effectively the terminal elevator problem;[17] the persistence of "big business" in flouting or ignoring the public interest—these are examples of questions which involve the relation of business to the public, and of classes of business with each other. In each case the failure of the parties involved to come to a suitable agreement has caused the government to restrict, regulate, and control.

[17] See J. E. Boyle, *Speculation and the Chicago Board of Trade*, pp. 97–113.

Finally, associations of business men may themselves develop undesirable business practices which the government must control. Among the most common of these is the making of agreements concerning prices, an act which is usually felt to be contrary to the public interest. The exact legal limits to the acts of associations in relation to prices have not yet been determined by the courts. But their efforts have frequently been held to overstep the bounds of public policy.[18] They must, apparently, be watched and controlled by the state.

Mandatory Acts which Elevate the Plane of Competition.—The enforcement of contracts and the tendency to moderate the rule of ~~*caveat emptor*~~ tend also to elevate the plane of competition. Business is dependent ~~upon the enforcement~~ of ~~contracts.~~ It cannot be carried on without a proper regard for contractual obligations. Trade associations have done much to standardize contracts and to provide machinery for arbitrating questions arising therefrom. But back of all, the power of the courts to enforce contracts looms as a restraining influence on the contract-breaker. The fact that a contract can be enforced at law is an important element in making such enforcement unnecessary, and consequently, in expediting business.

The increased variety of goods now offered for sale, the development of sale by sample and description, and the growth of large scale business, have made it necessary to mitigate the old rule of *caveat emptor.* Trade associations have also accomplished much in this direction. But for the protection of the final consumer and of many small traders it appears that only the state has thus far acted effectively. Good illustrations of legislation designed to protect the buyer, and in some cases the seller, from competition which leads to short weight, adulteration, and similar evils, are the pure food and drug acts of the Federal and state governments, the Federal meat inspection act, and the Federal Trade Commis-

[18] See pp. 389–390.

sion Act. The first, for example, is an attempt to prevent adulteration and misbranding, to make all drugs conform (in the case of the Federal act) to standards of purity determined by the national pharmacopœia, and to force manufacturers and vendors to state on containers of canned foods and patent medicines their content of dangerous drugs. The Federal act provides for an administrative agency, the Bureau of Chemistry of the Department of Agriculture, which is empowered to take the initiative in enforcing the act.[19] The regulation of weights and measures is another illustration of this kind of legislation, and somewhat in this vein is the Federal Produce Inspection Act passed in 1919. This law gives the Department of Agriculture power "to investigate and certify to shippers and other interested parties the quality and condition of fruits, vegetables, poultry, butter, hay, and other perishable farm products, when received in interstate commerce," [20] at important central markets. Other examples of state efforts designed to elevate the plane of competition are shown in Outline I.

Outline I: Government Efforts to Elevate the Plane of Competition

1. Establishment and enforcement of standards
   a. Monetary regulation and banking laws
   b. Standardization of money, credit instruments, weights, measures, and commodity grades
2. Restriction of unfair trade practices
   a. Common law doctrine designed to maintain fair conditions of trade and competition
   b. Control of trade practices
      (1) Federal and state anti-trust acts
      (2) Federal Trade Commission Act
      (3) Legislation controlling the activities of produce exchanges and commission merchants

[19] See the annual reports of the Bureau of Chemistry.

[20] See *Rules and Regulations: Food Products Inspection Law of March 3, 1921,* Circular No. 155, Office of the Secretary, U. S. Department of Agriculture, August, 1921.

   c. Control of transportation rates and services; allocation of cars; elimination of discrimination between persons, places, and commodities
   d. Statutes concerning patents, copyrights, trade-marks
3. Restraint of fraud, adulteration, and the sale of harmful products
   a. Common law doctrine
   b. Pure food and drug acts (federal, state, and local)
      (1) City ordinances concerning the milk supply
      (2) Inspection of meat and cold storage products
      (3) Regulation of the duration of storage
      (4) Prohibition of adulteration of products
      (5) Prohibition of false labeling and false branding
   c. Control of weights and measures: including requirement of statement of net content of packaged goods
   d. Certain aspects of state control of banks, insurance companies, and building and loan associations
   e. United States Bankruptcy Act
   f. Blue sky laws

Legislation of the kind discussed in the previous paragraph has become necessary because the average consumer does not have the technical knowledge which may be necessary to protect him against adulteration, misbranding, and similar evils; nor does the average consumer, small producer, or vendor have the financial strength which is necessary to protect him against unfair competitive acts. The small volume of business involved in many transactions is another thing which may justify legislation of this kind. The average small buyer does not have the time to determine qualities, and his purchases are so small that it would prove too expensive to do so. He must, consequently, depend upon the integrity of the producer and vendor of the goods he purchases,[21] or upon a government which is looking out for his interests.

The important characteristic of legislation of this kind is that an administrative agency is created, charged with the duty of protecting the public. This agency acts not only upon

[21] See pp. 24–25 and pp. 400–401.

the complaint of injured parties, but upon its own initiative. It devotes its time to the protection of the public. This kind of activity is made particularly effective because it is possible for the administrative agency to prevent undesirable practices. This is in marked contrast to ordinary court action which, except in the use of the power of injunction, takes place after the act has been committed. Court action, moreover, is usually slow and expensive. The expense alone is commonly prohibitive, and the time involved is so great that redress in the courts may come too late to be of value to the injured party.

(2) **The Control of Monopoly.**—The second group of governmental activities affecting marketing, includes those efforts aimed to protect citizens against the encroachments of such monopolies as are the fruit of the industrial revolution.[22] That is, when the greatest industrial efficiency can be realized under conditions of complete or partial monopoly (whether local, sectional, or national) some form of control is necessary in order that the results of this efficiency may be assured to the public. This can usually be accomplished only through governmental action. Some businesses of this kind are what may be called "natural monopolies." They are usually businesses of increasing returns.[23] Monopolies, which are due to the privileges of the patent and copyright laws, or to the control of natural resources, are also among those which must be regulated in the public interest.[24]

[22] H. C. Adams, *op. cit., Publications of the American Economic Association,* Vol. I (1886), pp. 47–63.

[23] *Ibid.,* pp. 55–64.

[24] Efforts to break up those "monopolies"—commonly called "trusts"—which have been formed by private initiative to control competition or to remove it, are of the first class, i.e. to control competition. The Webb Act, providing for combinations in foreign trade, is perhaps an exception, since it provides for just such control as is described under the second class to be exercised by the Federal Trade Commission. For further information on this act see recent reports of the Commission.

OUTLINE II: EFFORTS TO CONTROL MONOPOLISTIC TENDENCIES

1. Sherman anti-trust act
2. State anti-trust acts
3. Federal Trade Commission Act
4. Interstate Commerce Commission Act
5. Acts regulating public utilities
   a. State railroad and warehouse commissions
6. Wartime activities for price-fixing and rationing in fields normally considered competitive.

Two important considerations are involved in the formation of monopolistic organizations, such as public utilities, and of combinations, such as the "trusts," which tend to become monopolistic. One reason for the public's acquiesence in the formation of the former is the increased effectiveness and economy which result from unified control and operation. The same reason is commonly advanced as a cause for the formation of combinations or "trusts." The other consideration is the desire of the owners of the monopoly or combination to gain control of the sources of supply of the service or commodity so as to control competition and price. It is now generally accepted, in the case of public utilities, that monopolistic conditions do lead to economy in operation and to more efficient service. But the abuses of monopoly are also recognized and the state regulates and controls service and charges in the public interest.

These conditions are not so generally accepted in the case of large industrial firms and combinations. The attitude of American legislatures continues to be one of opposition toward industrial combination. The evidence is not entirely conclusive that these large combinations lead to economies which are important enough to justify the monopolistic tendencies and unfair methods of competition which they sometimes exercise. The Sherman Anti-Trust Act and many state anti-trust acts have been based upon the idea that these combinations restrain trade and should be abolished. It is difficult to distinguish between combina-

tions which do exercise an unwarranted restraint of competition and those which do not. There seems to be a tendency, however, for the Federal courts in interpreting the Sherman Act to distinguish between combinations, or large corporations, operating as a unit and thereby achieving any possible economies arising from unified operation in production as well as distribution, and those loosely formed combinations whose operations are confined to efforts to control competition. In the case of the United States *v.* the United States Steel Corporation, the court held [25] that, although the corporation might hold a dominant position in the industry it had committed no acts in violation of the Sherman Act since the government's suit had been started, and also that to dissolve the corporation might cause financial and economic disturbance. Although the court did not discuss the point, this corporation is a single operating unit.[26] On the other hand the court held that the Hardwood Lumber Association was a combination in restraint of trade.[27] Its efforts controlled competition. And it was a combination of competing units which could not be compared with a single operating unit of large size, such as the United States Steel Corporation.

State Control of Competition and Monopoly.—The first two groups of government activity—those designed to elevate the plane of competition and to control monopoly—are primarily regulative and restrictive in their nature. Their purpose is to do away with abuses, or to control forms of busi-

[25] 251 U. S. 417. The case was decided March 1, 1920.

[26] This decision was not in accord with those rendered in the case of the Standard Oil Company (221 U. S. 1) and American Tobacco Company (221 U. S. 106) cases in 1911, but the majority held that these corporations had been law breakers from their inception, and there was no evidence of this in the case of the Steel Corporation. Two members of the Supreme Court did not take part in the case and the decision of the other judges was four to three. So the case may not become a precedent.

[27] See pp. 389–390.

ness activity which are socially advantageous if kept within proper bounds. Their intent is not primarily to promote the technical efficiency with which business is carried on. It should not be inferred, of course, that they do not tend to foster efficiency. That is usually the final aim. Their immediate purpose, however, is to control or regulate industry in the interest of the general public, whether that leads to greater or less technical efficiency at the time. In fact, the result of such regulation may retard technical efficiency; but when this is true, it is an incidental result of the effort to guide business into channels which are considered to be more consistent with the public interest.

There are thus certain types of state action which seem to be imperative. Among these is the exercise of the power to force public utilities—railroads, gas and electric plants, and public warehouses, for example—to give impartial service. This has apparently been impossible without government regulation. The proper functioning of business is now so dependent upon public utilities that even though recourse may be had to the courts when unfair methods are used the process is too slow and expensive—for business cannot wait. A chief purpose of railway control has been the prevention of unfair discrimination in rate-making and service as between competing persons and places.[28] Another important purpose is to prevent the development of monopolistic tendencies which the rebate policy tends to foster.

(3) Efforts to Make Distribution More Effective.—The third class of state relations to marketing consists of those efforts designed to increase the technical efficiency with which it is carried on. Many of these have already been described. There are a number of important activities leading toward better marketing in which independent business men, particularly those operating on a small scale, cannot engage. This is the case either because they have not the

[28] See J. T. Young, *op. cit.*, pp. 122–132; W. Z. Ripley, ***Railroads, Rates, and Regulation,*** Chaps. VI, VII, XIII–XVII, XIX.

resources or because legal authority is lacking. Among these activities are investigation and research into existing methods of distribution, the collection and distribution of market information, and the establishment of commodity standards.[29] For the great bulk of business men (including, of course, farmers) activity of this kind can be effectively carried on only by associative effort or by the government. It has been quite generally assumed that the state could perform such services most effectively. This is because of its financial resources and because government agencies are sometimes given the legal authority to collect information from private firms. The importance of these efforts is patent, but there has always been a question as to whether they should be carried on by the government.

OUTLINE III: EFFORTS TO PROMOTE EFFICIENCY IN MARKETING[30]

1. The establishment and enforcement of standards
   a. Monetary and banking systems
   b. Weights and measures
   c. Standard containers
   d. Commodity standards
   e. Grading and inspection systems
   f. Standard bills of lading
   g. Standard warehouse receipts
   h. Warehouse inspection and license
2. Compelling railroads to unity of action and improvement of service
   a. Transportation Act of 1920
   b. Public utilities regulation
3. City plans—providing for:
   a. Better location of wholesale markets and railroad terminals
   b. Establishment of "city markets"
4. Financial activities
   a. Federal Reserve System
   b. War Finance Corporation
   c. State bank control

[29] See Chaps. XV, XVI, XVIII, XIX.

[30] It will be seen that many of the activities which aim to control competition also promote efficiency in marketing.

5. Research, statistical, inspection, and regulative activities
   a. Bureau of Foreign and Domestic Commerce
   b. Consular Service
   c. Federal Trade Commission
   d. Tariff Commission
   e. Bureau of Standards
   f. Bureau of Census
   g. Bureau of Markets (state and national)
   h. County advisors
   i. Universities (state and municipal)
6. Bounties, subventions, tariffs[21]
   a. Sugar bounties
   b. Ship subsidies
   c. Tariff restrictions
7. Restriction of activities of foreign business men in domestic and colonial markets
   a. Restrictions on foreign shipping in domestic ports
8. Financial aid to business men
   a. War Finance Corporation
   b. Moritoria
   c. Ship Subsidies
9. Enforcement of Contracts
10. Direct assistance to those engaged in marketing
   a. Issuance of government pamphlets advising of superior methods
   b. Parcel post
   c. State and Federal market bureaus
   d. Efforts of state market bureaus and postmasters to bring buyers and sellers together

The rapid development of trade associations among manufacturers, middlemen, and farmers, has shown that many of these activities can be successfully performed by associated efforts. If the consumer's coöperative movement spreads from Europe to this country and if the growth of trade and agricultural associations continues at the present rate, it is entirely possible that many of the activities now performed by state agencies, as well as others which are now proposed, will be taken over by these associations. Then

[21] No attempt has been made to place taxes in these groups. As a rule they should be considered as a distinct class.

the position of the state in relation to these matters would become purely regulative and mandatory.[32] That is, the government would control the associations' efforts in the public interest. It might also be called upon to arbitrate questions involving conflicts of interest between associations, and finally it might enforce decisions which had been made by arbitration boards under association rules.

[32] On this problem as related to market information see pp. 392–395.

CHAPTER XXIV

THE ELEMENTS OF MARKETING EFFICIENCY[1]

To criticize our marketing system, and to asperse those engaged in marketing has long been popular with reformers and demagogues. But, in view of the dearth of precise information, to criticize the existing market régime in more than general terms is scarcely warranted. Even to discuss intelligently the marketing of a specific product or the effectiveness of a particular market institution or agency necessitates the greatest care, because of this lack of accurate information.

In preceding chapters many of the points in the present system of marketing which call for criticism have been discussed, and the specific efforts which are being made to improve these conditions have been mentioned. It is the purpose of this and of the succeeding chapters to point out the elements of marketing efficiency which must be considered in evaluating particular market methods and institutions, to criticize certain aspects of distribution, and to point out certain ways in which improvement may be expected.

"Private" and "Public" Points of View.—Two points of view must be kept in mind in an attempt to analyze marketing efficiency. Such analysis may be directed from the point of view of the individual enterpriser, or of particular classes of business men. This is commonly called the private point of view. Investigations like those which have been carried on by the Bureaus of Business Research of Harvard and Northwestern universities are of this kind, as are most of the efforts

[1] Parts of this chapter are taken from a paper which was read at the Thirty-third Annual Meeting of the American Economic Association. This was published in the *American Economic Review,* Vol. XI, No. 2 (June, 1921), pp. 214–220.

of the United States Bureau of Markets, and of the bureaus of commercial research maintained by some large business and trade organizations. Other analyses are carried out by investigators who are not interested in increasing the profits of individual firms or of particular classes of private business organizations. Such investigators take what, for the lack of a better term, may be called the social or public point of view. Their aim is to study the social significance of marketing. In so far as they have any definite aim in mind other than the scientific search for truth, it is to determine how marketing can be carried on in such a way as to improve the economic status of the community as a whole. To these, marketing appears as a great mechanism for bringing goods and services from producer to consumer. This mechanism functions imperfectly at times and involves expensive processes. Consequently, it is worth study in order to determine whether it can be made to function more effectively and more economically.

The specific lines of research and even the immediate aims of those who take this latter point of view, frequently, perhaps usually, coincide with those who are interested only as individuals, or as the representatives of a large class of enterprisers. But whereas those with the individual perspective are interested because they seek a means to increase individual profits, these latter are interested in individual success only in so far as it tends to the development of a more effective and a more economical distributive organization. This second point of view is that of the following discussion. In the last analysis, this brings those who are individualistic in tendency to the position of the consumer. (The social end of marketing, as of production, is to gratify the wants of consumers as effectively and as economically as possible. And so it is from the point of view of the investigator who sees marketing through the consumer's eyes that the component elements of marketing efficiency are here approached.

Components of Marketing Efficiency.—What, then, are

the elements to be considered in determining the efficiency of our market organization, and of the particular institutions of which it is composed? First among these must be considered the effectiveness with which the distributive service is rendered; then, the cost at which this service is performed, cost being understood to include actual expenses plus whatever profits are made by those engaged in marketing, whether they be producer, consumer, middleman, or functional agency. And, finally, there must be considered the effect which this cost and these methods of performing this service have upon production and consumption. In other words, to determine the efficiency of our market organization we must answer such questions as these: does the scheme meet our needs? do we pay more for the performance of this service, even though it is well done, than we should? what effect does our system of market distribution have upon production and consumption? If the system is effective but costly, it is inefficient. It is inefficient, too, when it is cheap but ineffective. And even though the mechanism as devised, results in the effective and economical distribution of commodities, it is not efficient if it exercises an unfavorable influence on either production or consumption.

Problems of Technical Efficiency.—It is evident that the first two elements of marketing efficiency, service and cost, must usually be studied as composing one problem, although the emphasis of a particular investigation may be upon service, or upon the actual money cost, or on the trade or speculative profits involved in the performance of the service. Most of the problems which are encountered, perhaps all of them, raise broad questions of technical efficiency. One group centers about the purely mechanical elements involved in transportation and storage. Among these are questions concerning the effectiveness of the facilities for shipping and warehousing, and concerning the mechanical equipment and physical layout of markets. Difficulties are caused by poor country roads,

limited railway facilities, congested terminals, and ill-planned wholesale market areas. One of the greatest problems in the market for agricultural products is found just here. How can the advantages derived from concentrating at these central markets the forces of demand and supply which operate over a wide area be retained; and at the same time, how can the disadvantages of the physical congestion of the market plants, which arise from the resulting tendency to force an enormous supply of actual goods through these markets, be eliminated?

Another group of problems concerns the methods by which title to goods is transferred from producer to consumer. Here are raised a number of questions of the most vital importance. Among them are those which relate to the efficacy of the market news service, upon which we depend to keep demand and supply in equilibrium; those which deal with the adequacy of the price system to correlate properly the various factors in production and marketing; those which concern the legal protection of the parties to an exchange; those which relate to the great costs involved in buying and selling—including the costs of standardization, inspection and grading, when these services are performed, the increased costs of bargaining, when they are not provided, and the enormous costs of demand creation. Here also center the problems which arise from the presence of market risks and the necessity for market finance.

These two groups of problems concerning the technical efficiency of our market machinery, one arising out of what may be called the purely mechanical efficiency of the plant, the other arising out of what may be called the trade efficiency of the system of bargaining, bear directly on those components of efficiency which are based on service and cost.

Effects of Market System upon Production and Consumption.—More difficult of analysis, but no less important, are the problems which relate to the influence of the existing

market institutions upon production and consumption. They involve some most interesting and illusive considerations—considerations which the business man and the economist learned to appreciate only when the World War magnified their difficulty and increased the need for their immediate solution.

They include such questions as the effect of the use of standard grades, when it results in improved products and increased stability of income to producers.[2] And here, too, may be considered the effect upon production when the market organization secures to the producer what he considers to be a "just share" of the final selling price of his product. Here is raised the whole series of questions concerning the results on production and consumption of market competition and of the effects of particular railway rate structures—basing points, postage stamp rates, commodity rates, rates based upon a compromise between value of the product, weight, distance, and the competition of other carriers and of outside markets. Here, likewise, can be considered the effect of finance and warehouse methods upon the production of perishable and seasonal commodities, as well as the reactions to large market areas which have caused the growth of large scale and specialized production. In connection with consumption, there is need to investigate the tendency for modern distributive methods to make available to consumers a large variety of commodities, and the tendency of modern selling methods to create in the mind of the consumer a demand for variety, quality, service, style, and seasonable goods.

Criticism of the Competitive Régime.—Most of the criticism of modern marketing is really pointed directly or indirectly at our competitive régime as it now functions. Even the important problems of the physical efficiency of transportation, and of the physical congestion of central market areas, are very closely bound up with the conditions of competition in a régime of private property. Most of the proposed reme-

[2] See pp. 247–248.

dies and reforms, which are of more than particular application, propose to eliminate our present competitive system; or else they involve proposals leading to an increase in existing forms of control on the part of the government, or to an introduction or enlargement of the control exercised by producers, middlemen, and consumers through some form of coöperation or combination.

It has been shown that demand and supply are not properly related.[3] As a consequence there occur what are popularly called periods of over- and underproduction. These may occur in many lines at a single time and may result in a general paralysis of business, or they may be found with certain products or in certain markets, as when there is a larger supply of apples than the market demands, or when there is an excess supply of perishable fruit dumped into a particular market on a Saturday afternoon. It is contended, likewise, that the system is so developed that the physically best or nearest producing areas are often kept from supplying their logical markets, because no adequate means of contact has been established or because transportation rates are constructed with a view to bringing distant areas into more favorable competitive relationships. Again, consumers are so played upon by the competitive efforts of merchandisers that they are held to have developed unwise and extragavant demands. It is further contended, and often proved, that of a given price at a given time the producer (and in particular the farmer) gets too small a share. Or it is held, conversely, that, with the producer receiving a particular price, the consumer is forced to pay more than he should; or, again, that the producer may have goods to sell and the consumer desire to purchase them, but the market machinery fails to bring about an exchange. Two causes are, of course, given for the large spread between producer and consumer: inefficiency of method, and the opportunity for withholding too large a margin of profit by the various intermediaries involved.

[3] Chap. XVII.

Either may be the result of the failure of our competitive régime to develop effective methods and to keep prices down to a proper margin of profit.

Other wastes, which in some cases can be placed at the door of the competitive régime, but which, more often perhaps, are due to a failure to develop effective and economical mechanical equipment, are those which occur when it does not pay producers to harvest and market products; when products deteriorate en route to market or after reaching it; and when products occasionally are allowed to perish, even when they are well on their way to the final consumer, because it does not pay those who hold them to carry them further.

It is evident from these illustrations that many of the criticisms now leveled at the market organization hit at the heart of our competitive régime—the effectiveness of the price system. It is generally held by apologists for the existing state of affairs that economic progress is greater under a régime of competition than it is conceivable it could be under any other, known or proposed. Briefly, the argument is that the best men and the best processes and policies evolve, and that the goods and services which are wanted, are produced most effectively and most economically. As applied to marketing this means that the most efficient firms will survive, that the best channels of distribution and the best methods of selling will prevail, and that commodities in the amount, kind, and quality demanded will be placed upon the market. Finally, as regards price and cost, competition will reduce price to costs, including a reasonable (socially necessary) profit, but still maintain it at a point which will insure the required production. This ideal comes very far from being realized, however, especially when conditions are changing so rapidly that attempted solutions of problems of production and marketing are often out of date by the time they are fully evolved. In consequence, the process of selection when working through price is, in times like the present, slow and expensive, for competition is slow to weed out the inefficient producers and

distributors and their methods. But the advocates of the existing system, while recognizing this, hold that it is the best scheme of production and distribution which has been devised, and argue that many of the proposed remedies, such as socialism and the use of combinations tending toward control of particular kinds of industry, whether by manufacturers, by agriculturalists, by middlemen, or by consumers, will bring greater evils than are these wastes of competition.

A large group of investigators has long since taken it for granted that the competitive régime as we know it is inadequate and must be supplemented or abandoned.[4] True, the point has not yet been reached where the schemes for the complete abandonment of competition need seriously be considered as a practical program. But there is a dominant feeling to-day that, while we may depend upon competition to maintain and increase private efficiency, that is, the efficiency of the individual entrepreneurship, something more is necessary to bring about a proper correlation between individual activities, particularly between the efforts of producers or consumers of specific products, and so to promote general efficiency. As an eminent investigator has said, "Coördination within an enterprise is the result of careful planning by experts; coördination among independent enterprises cannot be said to be planned at all."[5]

Importance of Service.—In any criticism which may be made, the investigator must be careful to balance properly the service rendered against the cost. Too often the former is forgotten. If the buyer demands service he must pay. Censure should sometimes be leveled at him rather than at those who render the service or at the market system. That is, the consumer should be censured unless the very activities of

[4] The reasoning of one group of critics is clearly set forth by C. R. Van Hise in *Conservation and Regulation in the United States During the World War* (1917–1918); see also Chas. P. Steinmetz, *America and the New Epoch* (1916), for an entirely different kind of proposal.

[5] W. C. Mitchell, *Business Cycles*, p. 38.

those who render the service, or of others back of them, tend to increase his demands for service. And even then the critic must be certain that the service itself is a bad thing or less desirable than something which has to be foregone, or that it is inefficiently performed or allows undue profits to be accumulated.

If there is a wide spread in price between producer and ultimate consumer, if 50 per cent or more of the final price of an article is the marketing cost, this does not necessarily indicate either inefficiency or excessive profits. On closer examination it may be found that neither of these evils is present, that the service is actually costly. Or it may be found that what is done warrants an investigation, not of the market, but of human desires, or of modern large scale methods of production, or of the nature and effects of modern railway rate structures. It is evident that the relative cost of marketing most commodities has increased in recent years and that relatively more individuals and more capital are engaged in distribution.[6] In so far as this is a result of modern conditions in production and consumption, our investigation should start there. But in so far as our modern distributive system has operated to bring about these conditions in production and consumption we return whence we started, and our field of investigation is the market organization.

The Determining Conditions of Modern Marketing.—Any investigation of market efficiency should start with certain facts clearly in the investigator's mind. Just so long as we have large scale production and specialized producing units and production areas, just so long as consumers congregate in small areas far removed from the source of the products which they demand, and just so long as we possess wants which can be gratified only with products from remote sources, or products perishable physically or commercially, just so long we must have large markets and a large and intricate

[6] Nystrom has gathered some interesting data on this point. See his *Economics of Retailing* (2d ed., 1919), pp. 338–345.

market organization. And the larger producers become, the more specialized production and production areas develop, the more consumers congregate and the more numerous their desires become, the more important, and probably the more costly, the market machinery will be. It must be recognized, for example, that the benefits of specialization in production are in part offset by the increased costs of distribution, which are necessary to bring about the proper coördination between the work of the specialists. And this refers not merely to the cost of physical storage and delivery, but to the increased cost of financing, to the increased market risks which must be borne, and to the increased sales effort which the larger producer feels that he must make in order to minimize these risks. A point is soon reached in some industries where the increased costs of distribution—particularly those of transportation—offset any advantages of large scale production.

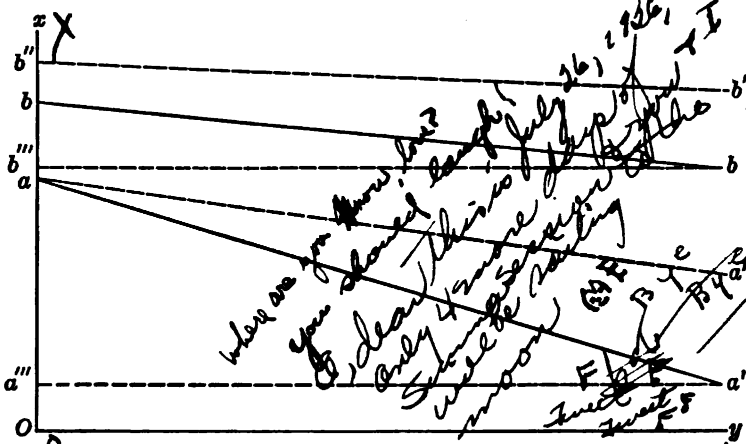


Diagram VIII

Diagram VIII illustrates this point in a graphic manner. The total costs of production and marketing are measured along the line XO, and the passage of time during which large scale specialized production is developing is represented from left to right along the line YO. The line

aa″ represents the decreasing cost of making a product formerly made in the home,—(and so with no costs of marketing) as clothing, butter, bread; and the line

aa′ in relation to the line aa″ represents the increasing cost of marketing the product as large scale production develops. The line

bb represents the declining costs of making a product—which, however, was *not* made in the home—as larger scale production is used, and the line

b″b′ in relation to the line bb represents the increasing costs of marketing it as an increasing scale of production is introduced.

It is conceivable that the difference between bb′ and bb″, representing increasing costs of marketing, may become great enough to offset bb‴, representing the declining costs of production; likewise, that the amount a′a″, representing the marketing cost, may become greater than aa‴, representing declining costs of production. That is, the increased cost of marketing which may become necessary with increasing scales of production, may be greater than the reductions in the cost of production. In this case the *total* cost would be greater than it was originally.

It may be that society will some day discover that it must consciously balance against such increased costs of marketing not only the advantages of large scale production, but the advantages of further specialization by producing areas, and the pleasure the consumer derives from variety and service, just as individual consumers are constantly doing.

CHAPTER XXV

THE COST OF MARKETING

The purpose of the present chapter is to discuss some of the more specific criticisms of the marketing system. One of the chief indictments is that distribution is too costly—that too much of the consumer's dollar is absorbed in marketing, or that the producer receives too small a part of that dollar. It was shown in the last chapter that if this is true, it may be (1) because the expenses involved are greater than the service performed by the market machinery warrants, (2) because too much service is rendered, or (3) because those who render the service obtain too large a profit, over and above the expense they incur. With a commission composed of eminent engineers, headed by Mr. Herbert Hoover, implying that production, which has been studied scientifically by trained engineers for more than half a century, is often only 50 per cent efficient,[1] it would be surprising indeed if marketing, which has been studied scientifically for not over a dozen years, and by a much smaller group of men, largely self-trained, were not found to be far short of the maximum of effectiveness. Since the nature of marketing is largely determined by the conditions of production, and since much of the present market machinery was unnecessary until modern production methods were developed, it is but natural that the scientific approach to marketing should have lagged behind the scientific study of production engineering.

Cost of Marketing.[2]—Business men and the public are

[1] *Waste in Industry* (1921), by the Committee on Elimination of Waste in Industry, of the American Engineering Societies, p. 9.

[2] The terms "cost" and "expense" are used interchangeably in this chapter.

interested in the costs of marketing for the same reasons that they are interested in the costs of production. The actual costs must be covered by selling prices if the product is to continue to come on the market. When there is an excessive spread between the cost of production and the selling price, a knowledge of selling costs makes it possible to determine at what points profits are made, and so serves at least as a starting point for determining whether these profits are excessive.[3] For if the margin between the cost of production—or rather the price which the producer receives, which in many cases really includes some marketing costs and some profits—and the final selling price can be determined, and if it can be shown how this margin is divided between the market functionaries, it clarifies the study of market costs, and may point to the weak spots in the market machinery. Detailed study of the weakest elements and of the more expensive would logically follow.

The existing information, unfortunately, is to a large degree unsatisfactory for use in answering such questions as these. It does serve, however, to point to some of the expenses involved, to show some of the conditions under which these would increase, decrease, and vary, and to throw some slight light on those activities which hold out the greatest hope for economy. It has already been shown that to generalize as to the efficiency of the general market machinery is impossible.[4] It is even relatively impossible to generalize as to the agricultural market, or the manufacturers' market, and often, because of the many and varying conditions surrounding its sale and distribution, it is impossible to generalize as to the efficiency with which any particular product is marketed. Large and small producers may be selling to large and small middlemen, who operate in large and small cities,

[3] Since expenses vary with individual firms, generalizations on profits are very difficult to make. Insufficient published data of this kind are at hand.

[4] Pp. 494, 501.

under differing conditions of costs and demand. And products vary among themselves as to perishability, the nature of the transportation and storage facilities needed, the risk arising from changes in market prices, the volume of sales, degrees of standardization, and seasonalness.

The Lack of Cost Data.—Data concerning the cost of most of the services involved in the performance of the specific market functions are not available.[5] But there is, nevertheless, sufficient information to throw light on a few points. The greatest amount of cost data is available in studies which have been made of the marketing of agricultural products, and of retail distribution. There are few figures in the manufacturing field which can be used, particularly concerning the marketing costs of the manufacturer himself; and where such studies have been made they are either not generally available for publication or else they are unsatisfactory.[6] Because of the paucity of data on actual expenses, the only attempt made here will be to show the margins on which some of the middlemen of certain classes have been shown to operate. Since the greatest interest centers in goods for personal consumption, and since more information is available concerning their distribution, the present discussion will be confined mainly to them.

Throughout previous discussions goods have sometimes been classified on one basis and sometimes on another. Commodities have been divided into consumption goods, equipment, and production goods. The latter have been divided into raw materials, semi-manufactured goods, fully manufactured goods to be assembled, and supplies. At other times distinction

[5] Specific rates for railway transportation, warehouse rates, bank discounts, etc., are available. But middlemen and producers perform these functions to a large extent, and few figures are available concerning their costs.

[6] Some valuable information has been collected recently by the Federal Trade Commission, and its work continues to develop. In the field of retail distribution valuable contributions are being made by the bureaus of business research of Harvard and Northwestern Universities.

has been made between farm products and manufactured goods. And, finally, a rough distinction has been made between staples—goods which are "bought"—and specialties—goods which are "sold." In the discussion which follows each of these classifications will be used.[7]

I

Cost of Marketing Farm Products.[8]—In the sale of farm products the process of concentration is of greater importance than it is in the sale of most other raw materials or of manufactured goods.[9] And it is in the marketing of farm products, destined for sale in the original state to final consumers, that the process of concentration followed by dispersion is found most fully developed. With farm products the channel of distribution sometimes has many and sometimes few steps. The typical case for consumption goods is one in which four middlemen appear: country shipper, wholesale receiver, jobber, and retailer. The evidence at hand indicates that of these four steps the one attended with least expense is the wholesale handling by the receiver.[10] Concentrating in the country and jobbing in the city cost a little more, and retailing is the most expensive part of the whole process.

A study of a number of investigations into the cost of retailing warrants the generalization—for the present purpose—that retail margins run close to one-third of the final price

[7] The last two distinctions will be developed in greater detail. This is partly because some of the points which could be made concerning the first classification were touched upon in Chap. XXI.

[8] See L. D. H. Weld, *The Marketing of Farm Products,* Chaps. IX and X, on the cost of marketing farm products.

[9] See pp. 39–42, and 115–117.

[10] See Table VIII, which is used only for illustrative purposes.

TABLE VIII. *Typical Dealers' Margins on Produce Commodities* *

	Shipper (per cent)	*Receiver (per cent)*	*Jobber (per cent)*	*Retailer (per cent)*
Butter	5–10	1–5	4–7	10–15
	....	1.1	4.8	13.9
	....	5.6	....	11.7
Poultry	5–10	2.5–5	5–15	10–25
	....	11.9	....	20
Eggs	5–20	1–5	3–10	10–20
	4.3	....	12.7	14.7
Cheese	....	4.8	10.2	21.9
Potatoes	10–20	1–5	5–15	15–25
	14.3	4.3	8.8	26.0
Strawberries	5–10	5–7	5–15	10–30
Oranges	....	2.6	12.3	33.3

* "That is, the percentage which the dealer's charge or increment is to the price which he gets for the goods, *not percentage of the consumer's price.* The writer believes that this method is better for our purposes, as showing the ratio of the marketing expense to the *value of the goods handled.* The message of the figures is not, however, entirely clear, owing to the fact that in several cases the margin represents the total 'mark-up' and does not differentiate waste from actual costs of marketing." The table and the explanation are taken from E. G. Nourse, *The Chicago Produce Market* (1917), p. 122.

which the consumer pays for his goods.[11] It seems reasonable to believe that the cost of retailing farm produce, especially perishables, is at least as high as this. However, figures in Table VIII are lower than this, as are figures cited by Weld.[12] But even if these lower figures are accepted as typical, they are, nevertheless, so high as to warrant the generalization that retailing is the most expensive step.

Further Expenses of Marketing Farm Products.—Other important costs in marketing agricultural products are the physical distribution of the product—hauling and other transportation, storage, and, in the case of perishables, refrigeration, pre-cooling, and cold storage—and the waste which results from ineffective market news.

Despite rapid transportation, refrigeration, and costly systems of obtaining market information, a great many perishables spoil through failure to reach the right market in time.

[11] Some of the figures in staple (and so low-cost lines) are given on p. 515.

[12] L. D. H. Weld, *op. cit.*, Chap. IX.

And whether highly perishable or not, farm products have even been allowed to spoil because it did not pay the growers to market them or the dealers to sell them in the market they were in, or—because of low prices or perishability—to send them to other markets where prices were better. The cause of variations in price between markets which bring about losses of this kind is, unless the goods are extremely perishable, the inadequacy of the market news service. Too many shippers have sent their goods to a given market, and so there are more goods in that market than it will absorb at a profitable price. Lack of information may also cause under- or overproduction of commodities.

Other weaknesses in marketing agricultural products have been mentioned from time to time in previous chapters.[13] These problems start at the farm with the failure of the grower to raise the products for which he is likely to find the best market; his failure properly to sort, grade, and pack his product, and his general lack of market knowledge.[14] Some of these same difficulties are found at country shipping points where there may also be inefficient shippers, too many or too few shippers, or monopoly conditions. One very great item in marketing most agricultural products is the cost of hauling on country roads. The obvious remedy for this is to improve the methods of transportation, and this is being rapidly accomplished through better roads and by the use of the motor truck.

It has been pointed out that there are opportunities for fraud and unfair competition,[15] that wholesale districts are often congested and physically inefficient, and that customs, grades, methods, packages, vary as between markets, making

[13] See also Weld, *op. cit.*, Chap. XXI; "Reducing the Cost of Distribution," *Annals of the American Academy*, Vol. L, No. 139 (Nov., 1913); Nourse, *The Chicago Produce Market;* and the *Report of the Federal Trade Commission on the Wholesale Marketing of Food* (1920).

[14] See pp. 36–37.

[15] See Nourse, *op. cit.*, pp. 59–60

standardization difficult.[16] All of these latter evils are more or less specific, applying to certain products or to some products in a few markets.

Total Costs.—The cost of agricultural marketing has been estimated as ranging from 15 to 65 per cent of the price paid by the consumer.[17] The higher costs prevail in the case of perishables. Thus the cost of transportation alone of California fruit amounts to 20 per cent of the final retail price, whereas for most products, the United States Department of Agriculture has estimated that but 7 per cent goes for transportation costs. The cost of wholesaling farm products is relatively low, varying from 5 to 10 per cent for such staples as corn, wheat, and cotton, and ranging somewhat higher in the case of perishables. Is is obvious that no safe conclusions of a general nature can be drawn either concerning the average cost of marketing, or regarding the average efficiency of marketing. Perishability, waste, and shrinkage, varying quantities that are shipped and handled, effectiveness of market information, extent of competition, seasonalness, the extent to which grading and inspection make sale by description or sample possible and so eliminate the cost of bulk inspection and sale—these are all important factors in determining the efficiency and the cost of marketing, and they vary greatly in their effects as between different products, different markets, and different seasons of the year.[18]

II

Marketing Manufactured Products: Staple Lines.—It has been shown that the cost of selling manufactured goods which are in the nature of special equipment or consumption goods is very high. In their physical distribution, it is largely

[16] One of the best recent criticisms is found in the *Report of the Federal Trade Commission on the Wholesale Marketing of Food* (1920).

[17] See footnote 13, p. 276.

[18] An excellent discussion of the difficulties involved in studying costs of marketing will be found in Nourse, *op. cit.*, pp. 118–128.

true that farm products, since they are more perishable and usually more seasonal, are more difficult to market. But these problems are understood and their solution by mechanical means is well on its way. In the field of selling there are distinct general differences between agricultural products, particularly the staples, and manufactured goods for personal consumption.[19] For example, estimates taken from government reports on certain staple industries indicate that (1) in the hosiery business, the cost to the manufacturer of selling to the retailer varied from 1 per cent to 29 per cent of the manufacturers' selling prices, with an average of 8.31 per cent;[20] (2) for knit underwear it was 2 per cent to 25 per cent, averaging 6.87 per cent; (3) for shirts and collars, 2 per cent to 18 per cent, averaging 5.88 per cent. To such costs, must be added the costs of retailing which can be safely set at 25 per cent,[21] or more of the final price paid by the consumer. The total cost of selling the products of the International Harvester Company was estimated by the Commissioner of Corporations at 17 per cent of its sales, and to this, for purposes of comparison, must logically be added interest on the money invested in the sales efforts (which, however, there is no way to estimate) and the costs of retail distribution. Of the price paid by the consumer for a pound of beef in 1920, 63.6 per cent was paid to the producer, 9 per cent was the packer's margin, and 27.4 per cent the retailer's margin.[22] Thus, it seems that in the case of these staple products, there is a selling cost of from 30

[19] The true distinction here is between consumption goods and production goods, but manufactured goods for consumption serve as a good illustration of consumption goods.

[20] U. S. Bureau of Foreign and Domestic Commerce, Reports in the "Miscellaneous Series," on the hosiery industry, knit underwear industry, collar industry, etc.

[21] It should be said that this retail cost is really a joint cost that cannot be readily differentiated for specific products handled in particular retail stores.

[22] Swift and Company, *Year Book,* 1920, pp. 44–47.

per cent to 55 per cent of the final selling price, if we include the general estimate of 25 to 33 per cent for retail selling costs.

Cost of Marketing Specialties.—Fewer facts are available concerning the cost of marketing manufactured specialties but even generalizations which are fairly accurate serve the immediate purpose. It is believed that the cost of marketing such manufactures ordinarily is equal to the production costs, if it is not, indeed, far greater. That is, over one-half the price paid by the consumer goes to pay for the cost of selling the product. These costs are largely for demand creation; that is, for the creation of demand for new products that consumers are not in the habit of buying. But much of the cost is a competitive cost for diverting competitors' custom or for sustaining the manufacturer's custom from the diverting activities of his competitors. In some cases a retailing cost is incurred by the manufacturer. For instance, many specialties, such as typewriters,[23] adding machines, and cash registers, are sold by manufacturers directly to consumers. This means that the cost which would correspond to the retail cost of selling must be very great, because the selling overhead must be apportioned upon a relatively small number of products in a single line.[24]

In the sale of an article which consumers are not in the habit of buying, a demand must, in the first instance, be created—usually by the manufacturer. That is, the consumer must be *sold;* he does not go shopping for such goods of his own free will as he does for staple goods. The competitive cost of marketing specialties is thus greater than that for marketing staple necessities for which the demand is relatively inelastic. This is because there is, in addition to the problem of competing with sellers of the same kind of product, the further problem of competing with sellers of

[23] It is claimed that marketing expense accounts for four-fifths of the price of some typewriters.

[24] For an understanding of this, the reader is referred to the discussion of manufacturers' middlemen and their services, in Chaps. VIII and IX.

other products, which may be used as substitutes. There is, too, the additional problem of competing with vendors of products which are not similar, but which are, nevertheless, competing for that part of the consumer's purchasing power which is available over and above his needs for the necessities and conveniences that have become staple.

III

The Cost of Retailing.[25]—The most expensive unit in the distribution of goods for personal consumption is the retail store. The average cost of retailing staple commodities ranges from 20 per cent to 50 per cent of the price paid by the consumer, and a very common cost is 30 to 35 per cent.[26] Figures of this kind prove nothing of themselves concerning the effectiveness of retailing. They do show, however, that we pay heavily for the retailer's service. Furthermore, the range in expenses of stores of substantially the same character is so great as to warrant the belief that a large percentage of our retail stores are operated at an excessive cost. Again, if the rate of stock-turn is accepted as an important measure of retail efficiency, the same conclusion must be drawn. This conclusion is borne out by the figures cited in Tables IX, X, and XI.

[25] For a number of wholesale margins see Tables V and VI, pp. 150, 152; 518, and the *Report of the Federal Trade Commission on the Leather and Shoe Industries* (1919), Chaps. V and VI.

[26] The National Retail Dry Goods Association, in a table accompanying their "*Resolutions Against 'American Valuation'*" (Oct. 14, 1921), use 33⅓ per cent as the "approximate" retail mark-up. This figure is commonly used. See also P. T. Cherington, *Advertising as a Business Force*, pp. 209–210, 382–383, 386–390. Many of the figures concerning retail margins are difficult to interpret, because it is not evident whether the margin mentioned is the maintained gross profit, or whether it is simply a mark-up, subject to reductions for sales, and other causes.

TABLE IX. *Retail Margins* ‡

Type of Store	*Lowest*	*Highest*	*Common, "Attainable,"* * *or Average*
	%	%	%
Retail grocery stores [1]	14.6	27.9	21.0
Retail grocery stores [2]	10.5	26.04	16.9
Retail grocery stores §	....	....	15.3
Total net sales			
Under $20,000 per annum	....	....	18.3
$20,000, under $50,000	....	....	14.2
$50,000, under $100,000	....	....	14.0
$100,000 and over	....	....	16.2
Retail shoe stores [3]	18.0 ‖	35.0 ‖	20 ¶–25 ‖
Retail shoe stores—selling low-priced shoes, i.e., up to $3.00 for men and $3.50 for women, on the pre-war basis [4]	18.3	40.4	25.7
Retail shoe stores—selling medium-priced shoes, i.e., from $3.00 to $6.00 for men and $3.50 to $7.00 for women, on the pre-war basis [4]	14.23	42.8	26.6
Retail shoe stores—selling high-priced shoes [4]	21.3	41.5	34.8
Shoe departments of department stores [4]	12.6	39.1	28.1
Chain shoe stores [4]	12.5	45.5	28.4
Retail hardware stores [5]	12.75	40.2	26.5
Retail clothing stores [6]			
Total net sales			
Under $40,000	Under 10‖	50–60 ‖	10–25 ‖
$40,000–$80,000	Under 10‖	30–40 ‖	15–20 ‖
$80,000–$180,000	Under 10‖	40–50 ‖	15–20 ‖
$180,000 and over	10–15‖	40–50 ‖	20–25 ‖
Coöperative stores [7]	10.5	24.4	17.7

‡ Gross profit unless otherwise shown.

* This is not an average but the figure about which the expenses of enough stores center to warrant considering it as an attainable figure for all stores of the class.

[1] Harvard Bureau of Business Research, Bul. No. 5 (1915).

[2] *Ibid.*, Bul. No. 13 (1920).

[3] *Ibid.*, Bul. No. 1 (1913).

[4] *Ibid.*, Bul. No. 10 (1918).

[5] *Ibid.*, Bul. No. 12 (1919).

[6] Northwestern University Bureau of Business Research, *The Survey of the Retail Clothing Industry*, Vol. III (1919), p. 262.

[7] Bexell, Macpherson and Kerr, *A Survey of Typical Coöperative Stores in the United States* (U. S. Department of Agriculture, Bul. No. 394, Nov. 3, 1916), p. 24.

§ Theodore Macklin and P. E. McNall, *What the Retailer Does with the Consumer's Dollar*, University of Wisconsin, Agricultural Expt. Sta., Bul. No. 324 (Jan., 1921).

‖ Total expense.

¶ That is, 20 per cent for stores selling "low grade" shoes and 25 per cent for stores selling "high grade" shoes.

TABLE X. *Annual Rates of Stock-Turn*

Type of Store	*Lowest*	*Highest*	*Most Common*
Retail grocery[1]	1.8	27.07	7.9
General merchandise[1]	0.86	13.1	2.4
Retail hardware[2]	0.85	5.75	1.8
Retail shoe stores[3]			
Selling low-priced shoes—up to $3.00 for men, $3.50 for women	0.6	4.77	1.6
Selling medium-price shoes—from $3.00 to $6.00 for men, from $3.50 to $7.00 for women	0.7	5.1	1.7
Selling high-price shoes—$6.00 and over for men, $7.00 and over for women	0.92	2.33	1.5
Shoe departments of department stores	0.89	3.1	1.5
Chain shoe stores	1.1	4.6	1.7
Retail clothing stores[4]			
Total net sales			
Under $40,000	0.6	5.0	1.0–1.5
$40,000 to $80,000	0.8	5.1	1.5–2.0
$80,000 to $180,000	0.8	6.3	1.5–2.0
$180,000 and over	1.2	6.1	2.0–3.0
Total (all stores)	0.6	5.0	1.5–2.0

[1] Harvard Bureau of Business Research, Bul. No. 13 (1919).
[2] *Ibid.*, Bul. No. 12 (1919).
[3] *Ibid.*, Bul. No. 10 (1918).
[4] Northwestern University Bureau of Business Research, *The Survey of the Clothing Industry*, Vol. V, p. 470. (The low and high figures are not yet published.) The figures are for 1919.

TABLE XI. *Stock-Turn in Department Stores* *

Department	*Lowest*	*Highest*	*Median*
Books	2.53	3.79	2.60
Boys' clothing	1.82	8.40	3.52
" furnishings	3.60	5.21	..
Furniture	1.14	6.10	3.40
Men's clothing	2.40	7.70	4.42
" furnishings	2.20	5.43	3.30
Millinery	4.21	14.40	8.70
Women's suits	5.70	18.30	9.15
" dresses	5.14	16.90	9.10
Shoes, Men's	1.93	4.60	2.70
" Women's	2.52	4.50	3.13
Silks and velvets	2.60	4.80	2.80
Stationery	2.00	3.40	2.89
Waists	3.70	8.40	7.70

* Figures are for departments of stores doing an annual volume of business of $7,500,000 and upwards, five stores reporting. Taken from a chart compiled by the Bureau of Research and Information of the National Retail Dry Goods Association (1919).

IV

Costs of Marketing Production Goods.—Production goods seem to be marketed with relative efficiency.[27] One of the great costs found in marketing consumption goods and special equipment, namely, demand creation and the competitive selling costs which so often accompany it, is almost absent in the sale of production goods. This is true because they, as well as standard equipment, have characteristics which are commonly well known to buyers and sellers, and which are easily determined through the use of established methods of grading and inspection.[28] It is also due in part to the fact that in their exchange both parties to a sale are efficient traders and are able to judge well the value of the merchandise. The size of individual transactions, moreover, usually warrants the expenditure of considerable time in determining qualities and characteristics and in arranging the conditions of sale. Superior products are, consequently, sold for higher prices than inferior products, and the exchange is transacted rapidly and efficiently. Stress is laid on the elimination of waste and of undue costs: that is the type of "service" which is demanded. There is little need or opportunity to stress the fact that Brown's bushel of wheat or Brown's steel bar is better than Smith's, for, if Brown's product is superior, the conditions are present which assure that it will be sold for more than Smith's.

Conclusions.—The data shown in this chapter are used only to point to a few broad generalizations of importance to any criticism of the cost of marketing. They have been cited simply to show certain typical tendencies. Since these—and other data like them which could be advanced—were gathered under diverse conditions, for differing purposes, and with

[27] In recent months, however, some farm organizations have held that immense loss comes to producers because of the lack of "orderly marketing" on the part of producers. See pp. 257–258.

[28] See Chap. XXI.

varying degrees of accuracy, conclusions of too specific a nature would be unwarranted.

The data serve, however, to illustrate, first of all, that the retail margin is the largest margin taken out by any class of middlemen. In fact, this margin is often as great as all of the other marketing expenses together, or even greater. The jobber's margin is commonly in the neighborhood of one-quarter to one-half of the retail margin, seldom more and often

TABLE XII. *Wholesale Margins* §

Type of Store	*Lowest*	*Highest*	*Common*
	%	%	%
Wholesale grocery *	6.08	14.9	11.0
Wholesale grocery †	7.7	17.2	12.0

§ Gross profits.
* Figures for 1918. Harvard Bureau of Business Research, Bul. No. 14 (1919).
† Figures for 1916, *Ibid.*, Bul. No. 9 (1917).

TABLE XIII. *Stock-Turns of Wholesale Dealers*

	Lowest	*Highest*	*Common*
Wholesale grocery [1]	2.8	11.6	5.7
Wholesale grocery [2]	2.48	19.03	5.2

[1] Harvard University Bureau of Business Research, Bul. No. 9 (1917).
[2] *Ibid.*, Bul. No. 14 (1919).

less. In the second place, there is a considerable variation in retail margins and in the rate of stock-turn in the same kind of stores. These facts are shown in Tables IX and X. These variations are so great that they cannot be accounted for on the ground that the fundamental conditions are different. They point undoubtedly to variations in the efficiency with which retailing is carried on. Table XII and Tables V and VI [29] show that the same thing is true of wholesale expense, but since the margins are smaller the variations are less. Furthermore, jobbing must be conducted very largely

[29] Pp. 150–152.

on a price basis, and less on a service basis than is retailing. This forces jobbers to reduce their expenses and tends to keep the expenses of all competing jobbers at about the same figure. Finally, these figures illustrate, also, the high cost of selling consumption goods.

CHAPTER XXVI

FINAL CRITICISM

I

The Wastes of Competitive Selling.—The two fundamental methods of selling are personal salesmanship and advertising. Of these, advertising is more usually singled out for adverse criticism, on the ground that it is a wasteful, extravagant means of competition. This is unfortunate, for much of this criticism, although it is directed at advertising, is really criticism of certain marketing polices of which advertising is simply one expression. Advertising is employed instead of, or to accompany the use of, personal salesmanship, the use of samples, or the display of goods, simply because it is thought to be cheaper or more effective. In fact there is little question but that in the selling of merchandise a far greater sum is spent on salesmen than on advertising. Few manufacturers spend as much on advertising as they do on salesmen. This is especially true in the sale of production goods and equipment. In wholesaling and particularly in retailing, the salesforce expense is usually the largest operating expense, and is far greater than the advertising cost.[1]

Criticism of advertising, specifically, rather than of selling costs, tends to give the impression that advertising is a costly method of selling, and even that it is responsible for costly selling. The reverse is usually true. For although the use of salesmen is commonly considered the more effective method

[1] See A. W. Shaw Co., *How to Run a Wholesale Business at a Profit* (1918), pp. xix-xxv, Harvard Bureau of Business Research, Buls. 10, 12, 13, 14; and Northwestern University, Bureau of Business Research, *The Survey of the Retail Clothing Industry* (1921).

salesman

of selling—cost ignored—it is often too expensive. This is especially true when individual sales are made in small volume and with a small margin of profit over production costs. Advertising, consequently, is used, not merely because it creates demand, but because, when substituted for other methods, it creates demand at a lower unit cost, or because, when it supplements the efforts of salesmen, sales costs decline. It is generally agreed that advertising in many instances has lowered selling costs as well as manufacturing costs. This is because it creates a large demand at a minimum cost and brings about the standardization of merchandise, thereby rendering large scale, standardized production possible. It has also assisted in lowering costs of production by smoothing the peaks of demand for seasonal goods into a more steady demand, and has thereby rendered continuous production possible.

It has been contended by some critics that as far as the consumer's immediate interest is concerned, socially legitimate sales effort should be devoted to the announcement of new articles or new uses for old articles.[2] The purpose to be served by an article should be explained and the way in which it served this need should be pointed out.[3] Improvements on existing articles and special prices could also be announced. But it may be questioned whether the consumer's long time interests would be served if selling were so confined. The inventors of many products which it is agreed have proved a boon to humanity have died poor. People would not use their product. It was only when they or some business man successfully *sold* the article that it was finally adopted. The problems which faced Watt, Corliss, Morse, Edison, the Wright brothers, and scores of others—because of the failure of the consuming public to take up their product—are familiar to all.[4] Most of the comforts enjoyed to-day have been made commercially possible only by sales efforts. Nevertheless the process is expensive.

[2] See, however, pp. 12–16.

[3] E. P. Harris, *Coöperation: the Hope of the Consumer*, Chap. I.

[4] See also F. W. Taussig, *Inventors and Money-Makers* (1915).

For not only are the facts concerning goods announced to us, but they are announced over and over and over again in every conceivable way. The consumer is not left to judge for himself but every effort is made to influence his judgment. Furthermore, mere announcement is not sufficient to satisfy competitive needs. Most products offered for sale are very much like competing products serving the same ends. But if announcements were of the kind suggested, individual producers might not get so large a share of prospective trade as they feel they would get if they could make the consumer think that their product is really very different from all competing articles and far superior to them. Consequently, some different "selling point" or points must be found to differentiate the product from its fellows—to individualize it. Then, by making the sales effort focus on this particular article, and its "different" characteristics, the seller tries to make prospective customers think they will make a great mistake if they do not get it in preference to others. Now this may often be true, but in the great majority of cases it will be found that many of these "selling points" are not particularly important characteristics of the articles sold.

Importance of Demand Creation Reviewed.—This last point now requires attention. The problem of demand creation is important to manufacturers of consumption goods.[5] Inasmuch as most goods of this class are not absolute necessities, but are necessities modified for selling purposes or else goods which cater to the desire for conveniences and luxuries, and since there are many more of such products on the market than the average consumer can afford to buy, it becomes a particularly difficult task to sell them. Thus, the manufacturer of a phonograph must first of all convince the prospect that he wants an instrument of this kind. And if the prospect's ability to spend, or his willingness to spend, is limited, he must be persuaded that he wants the phonograph more

[5] See pp. 12–16, 112–114.

than he wants a chair, or a new suit, or new paper on the wall, or that his desire for it is greater than his desire to put that amount of money into securities or in the bank. All of these and many other products and services are competing for the consumer's income, which for most individuals is at best enough to buy but a small number of the different commodities offered for sale.

In addition to the sales efforts which have jus en described, however, is that which is made to indu pur-chaser to buy a particular manufacturer's produc er than those of competing manufacturers who make a si product —to induce the purchaser desirous of buying music box to buy a particular make rather than any on a dozen or more brands offered on the market. It is evid that efforts of this kind arise out of the fact that the consumer is not "educated" to a realization of the "value" of the products offered for sale, and, more especially, to the further fact that there are neither definite, tangible criteria by which he can judge and compare goods meeting the same need, nor means by which he can evaluate the relative utility of goods catering to his different wants. It is essential to their success, then, for vendors to convince the prospective consumer that their particular product is the one most desired by him. This is costly.

Such Costs Eliminated When Recognized Standards Prevail.—Now extreme manifestations of this problem do not arise in the sale of goods that can be definitely measured as to quality and character. The purely competitive costs in particular are not found. It was shown in Chapter VI that this is true of most raw materials.[6] With them, quality can be readily compared on a basis of recognized standards.

[6] This is, at least, ordinarily true. It is conceivable that farmers who raise corn might combine and advertise so as to educate consumers to the value of corn as food, just as California fruit growers have combined to advertise citrus fruits. The Fleischmann Yeast Company is endeavoring to stimulate a greater demand for bread, which is commonly thought of as having in this country a relatively inelastic demand.

Competition, therefore, is on a price basis, and he who can produce and deliver most cheaply gets the best results, and only the most efficient producers can continue in business. Even when such goods are not graded and standardized, the buyer is usually skilled and so demand creative effort can be of little avail to the seller.[7] This is true of most other classes of production goods, and of standard equipment.

Branded Staples Introduced to Reduce Price Competition and Control the Market.—But in differentiating their product so as to obtain a more secure position in the market, manufacturers of consumption goods and of special equipment have made it difficult to compare their goods with other goods which are made to meet the same demand.[8] Having differentiated his product, the manufacturer tries to hold the market by individualizing it in some way and endeavoring to build up for it a good will which will be strong enough to counteract competition on a pure price basis. In other words, the product is differentiated so that it cannot be readily compared with others on a price basis, or even on a quality basis. When the product has been thus differentiated and a demand created for it, an endeavor is made to hold that demand through the process of individualization, which fixes the particular brand, rather than the general type of product, in the mind of the purchaser.[9]

Out of this condition has also arisen what has come to be known as the branded staple—a staple sold by "specialty" methods. The reason for branding a staple is to shift the general demand for a staple commodity into a specific demand for a particular brand of that commodity. It is not correct to say that these products are the old product merely changed

[7] Except as to "service," i.e., credit, deliveries, etc.

[8] Although the word "manufacturers" is used, the problem and the practice are found in wholesaling and in retailing this class of goods, and influence both wholesalers and retailers.

[9] Kodak rather than camera, for example; Victrola rather than phonograph. But definite social economies may result in the long run. See p. 16.

in some unimportant manner. Very often, in fact, they are definitely improved and even if the quality could be exactly determined, evaluated, and compared, they would sell in preference to cheaper products or similar products at the same price. But it is sometimes argued that the point to be made in this connection is that such methods enable many firms to remain in business longer than they would if the "improvements" had not been made or if they could be definitely measured and evaluated. In such cases, the good will which a firm builds up tends also to hinder the socially desirable results of competition. Finally, such selling methods lead also to excessive duplication of an expensive machinery for creating demand.[10]

In so far as branding shifts competition from a measurable (price) basis to what is often, for the ordinary ultimate consumer, an unmeasurable (quality) basis, it makes marketing more complex. To say that quality must be measured in either case does not refute this argument, because, in the case of many branded staples, the "quality" said to inhere in the product is some added "selling point" over and above basic qualities, one usually difficult for the consumer to measure on his scale of values, or to compare with other similar products.[11] Now, of course, improved products are desirable

[10] On the other hand, although certain results of extreme competition are generally recognized as undesirable, a good argument can be offered to show that shifting competition from a price to a quality basis is a distinct improvement in merchandising. See A. W. Shaw, "Some Problems in Market Distribution," *Quarterly Journal of Economics,* Vol. XXVI, pp. 742–746, and infra., p. 403.

[11] "The consensus of opinion among those who have given this problem careful study and have built their sales successes on it, has developed these basic principles:

"*a.* The merchandise must have at least one vital point in which it excels competitive merchandise. . . .

. . . .

"*It is actually wise to reshape merchandise* which has no vital argumentative individuality, so that it does have an individuality. Often there is excellent sales individuality in the process of manufacture or

and many of these undoubtedly are improvements, but the unfortunate result is the excessive amount of sales effort that is put forth to create demand. For when characteristics are hard to measure and to evaluate, it is difficult and expensive to buy and sell and the result may be that the social costs of demand creation become excessive. In this emphasis upon quality and differentiation, the consumer's normal desire for something good and for something different is preyed upon in an extreme degree by those who would sell products. Of course, in so far as this process leads to large markets and large scale production, with lowered costs, the net result is an improvement. An improvement in merchandising also results from the fact that when once he has found goods which satisfy, the consumer can thereafter buy by brand, and hence by description, rather than by inspection or sample.

Cause for Excessive Selling Cost: Inability of Consumer to Judge.—The conditions which make necessary this excessive competitive cost of selling have been discussed in previous chapters. The conditions which render it possible arise out of the inability of the consumer to judge readily the exact characteristics of the various products, to compare them readily with similar products, and to place them in his value scale in relation to other products of different kinds, which are nevertheless competing for his purchasing power. The consumer's inability to do these things is in part due (1) to the failure to develop any method by which the physical characteristics of the goods can be properly graded and classified and hence compared; (2) it arises further out of the different reactions of prospective purchasers to specific characteristics of merchandise; and (3) it is caused in part by the lack of time and inclination to "shop," learn qualities, etc.[12]

quality which has been overlooked."—J. G. Frederick, *Modern Salesmanagement* (1919), pp. 19–20. [The italics in the quotation are mine.] See also A. W. Shaw, *An Approach to Business Problems* (1916), pp. 245–254.

[12] See Chaps. XIX and XXI.

In the case of goods sold at retail, there usually are no generally accepted grades. The purchaser, too, is by no means an expert, or if he is an expert in purchasing a few things, it is impossible for him to be an expert over the great range of products that must be bought by the average consumer. And, furthermore, the small size of retail transactions does not warrant the buyer in making the effort to become expert, or to take the necessary time for examination if he is. The varying reactions of buyers to goods can merely be suggested. They relate to characterictics of goods which cannot be generally graded or described, and the reactions to which vary between individuals and even with the same individual at different times and under different conditions.[18] From these facts it follows that the average consumer does not know precisely what he wants, and he cannot judge products in relation to his wants and in relation to other products. Competing manufacturers and retailers try, consequently, to help him decide, in favor of their merchandise.

II

Importance of Standardization to Improved Marketing.—The use of standards in the sale of many production goods, and the possibility of technical tests of the qualities of others constitute one great element in reducing their costs of marketing. Such goods do not have to be "sold," as do many consumption goods. Their characteristics once determined, the buyer is then in a position to decide intelligently, regardless of sales pressure, whether they are worth as much as other goods which he has the opportunity to buy, or whether they are worth the price at all. This last point he can decide on the basis of his known costs of production and the anticipated selling price of the merchandise. But the finished products that emerge from these raw materials are divided into innumerable grades, and often have the intangible and in-

[18] See pp. 405–406.

definite characteristics which have been mentioned. This is true because, in the finished product destined for the ultimate consumer, style and appearance are often important. These cannot be evaluated, or, at least, are not, by simple physical, mechanical, or chemical tests, as can the qualities of raw materials. In consequence, many products differ from each other "by the intangible and esthetic qualities of shape, color, and design, which cannot be reduced to a single mechanical standard." [14]

But even the material content of consumption goods is more or less unknown. The consumer does not know the real content of his clothing, whether wool, wool and cotton, or shoddy;[15] of his canned goods, the quality of the product, its purity, or the amount of water or other useless ingredient in-

[14] Homer Hoyt, "Concentration and Its Relation to Industrial Standardization," *The Annals of the American Academy* (Mar., 1919), pp. 271–277.

[15] "The Winsted Hosiery Co. v. Federal Trade Commission, 272 Fed. 957 (CCA. Second Circuit).

"The complaint in this case charged that respondent had manufactured and sold underwear made of a small amount of wool and a large amount of cotton, which it labeled, advertised, and branded as 'Merino,' 'Wool,' or 'Worsted.' To the complaint the respondent made answer which was in effect a confession and avoidance, and attempted to justify the practice upon the theory that it had become universal and was well recognized by the distributors of underwear. An order to cease and desist from the practices charged in the complaint was issued, whereupon the respondent petitioned the Circuit Court of Appeals, Second Circuit, for a review of the Commission's order. The court, on April 13, 1921, filed its opinion and reversed the order of the Commission. Thereafter the Commission applied to the Supreme Court of the United States for a writ of certiorari to review the decree of the Circuit Court of Appeals, which writ was granted on June 6, 1921. The question presented in the petition for certiorari was whether the misbranding of garments made of cotton and wool, which misleads the consuming public into the belief that such garments are made wholly of wool, thereby injuring competitors who correctly labeled their products, constitutes an unfair method of competition within the purview of section 5 of the commission act."—*Annual Report of the Federal Trade Commission* (1921), pp. 29–30.

cluded; or the technical utility of the content of his toothpaste, although he may know that the container it is sold in enables him to use it more easily than any competing brand. Consequently, he cannot buy scientifically, nor with certainty. And, again, the manufacturer who can "puff" such wares with greatest success is the most likely to make sales. This is particularly the case where there is really little of ascertainable physical difference between the competing products.

Who Is Responsible?—Responsibility for this medley of designs can be laid fundamentally at the door of the consumer, to his desire for variety and distinction. But, on the other hand, this desire has been assiduously cultivated by sellers and has been played upon excessively as a result of the competition of manufacturers and other vendors.[16]

Psychical Element in Sales.—Some of the more extreme appeals that are made upon psychical elements in buying are interesting. We are told that this is the "highest priced" flour, varnish, or car on the market, not that it is the best, although that may be inferred. But the very fact that it is highest in price gives it a psychical value in the minds of many purchasers that it would not otherwise have. It is said that when the price of a well known automobile was cut one-third, the sales fell off at once. This was probably due to a variety of causes—to fear by some that the quality of the car would be lowered, although it was guaranteed that it would not be, but more likely because the price was still too high for small purchasers, and because the automobile did not now meet the demands of the class who desired to be known as having expensive cars. A phonograph sold by a large mail order house is said to be the equal of any on the market, but there are large numbers of buyers who, even though they did believe this to be true, would not buy it. They would

[16] Note the successful efforts of a few years back to introduce frequent style changes in women's shoes, and more recently a similar attempt with men's shoes and now, even spectacles!

hesitate to tell their friends that they bought it through the mail order house, with the inference to be drawn therefrom that they did so to save money. Some stores even advertise to the effect that "we charge a little more, but our service and our products are, oh! so superior." Others suggest it, and many others by stressing "quality" and "service" draw attention away from their higher prices. Even though superior quality actually inheres in certain products the desire for distinction rather than the fact that they are better goods often prompts their purchase.

III

The Middleman System and Marketing Costs.—A common cause which is assigned for the high cost of marketing is the middleman system. It is charged that there are "too many middlemen."

It was shown in Chapter XIV that the problems concerning middlemen are really of two kinds. First, are there too many kinds of independent middlemen handling products on the way from producer to consumer, and, second, are there too many middlemen attempting to perform each service? One arises out of the feeling that there are too many grocers, butchers, jobbers, hardware merchants; the other is produced by the belief that too many different kinds of middlemen "take their profit" out of the final retail price before the product reaches the ultimate consumer.

Are There Too Many Competing Firms?—It has already been suggested in this chapter that the excessive costs of competition arise in part out of the fact that there is an excessive number of competing products in the market. The complaint, consequently, that competition is excessive is not confined to those competitors, commonly called middlemen, offering marketing services; it is found throughout all business. There are too many manufacturers of competing products, and too many railroads in some parts of the country, as well as

too many middlemen.[17] At least as far as efficiency at a given time, as contrasted with the competitive results over a long period of time as evidenced in better methods, is concerned, this seems to be a safe conclusion—for those industries which have not been in large part monopolized. The lure of profit and the desire to be independent are so strong that men will start a competing factory, or a competing retail or wholesale store, when those already operating are perfectly capable of meeting the needs of the market; and when those already functioning, by operating on a large scale, could if left alone probably produce and market the goods at a smaller cost than is possible when more competitors enter the

[17] The following quotation summarizes some of the points thus far discussed as related to a specific industry: "In a survey of the distribution of wheat and flour, three things are noticeable: the intensely competitive character of the business, the excess in equipment for distribution, and the desire for independence of the people engaged in production and distribution. If one farmer will not sell his wheat at the price offered another farmer will. Local dealers, jobbers, and millers bid against each other in buying and selling. Flour is made in the town of A and shipped by rail to be sold in the town of B, while flour made in B is sold in A. A grocer in the east end of town hauls flour across the city to a customer in the west end of town, and the grocer in the west end delivers to a customer in the east end. The Minnesota miller sometimes buys Kansas wheat and the Kansas housekeeper sometimes insists on having Minnesota flour. And not only are the products crossing trails in distribution, but traveling salesmen of the many mills and flour jobbers are duplicating their labors in the same territory. Beginning with production, there are more seeding and harvesting machines in the hands of farmers than would be needed if there were coöperation in production and each machine kept in operation the entire harvest season. There are more elevators in the wheat area than are needed, each operating most of the time on less than its full capacity. In some sections, there is needless duplication of railroad trackage. More grain jobbers and commission men are in the field than can find continuous business. It is asserted that the mills of the United States could grind all the wheat raised in the United States in 144 days (24 hours per day)."—J. C. Bowen, *Wheat and Flour Prices from Farmer to Consumer,* United States Bureau of Labor Statistics, Bul. No. 130 (1913), p. 14.

field. That is, the larger number of competitors possibly results in increasing the costs of selling. Even if the introduction of new firms does not decrease the existing scale of operation, it may limit possible increases in the size of individual firms. In this way it may hinder savings from large scale operation in industries where that is important.[18]

Facts to substantiate such an argument can be readily found in some industries. Thus, when the whiskey trust was formed, some eighty or eighty-five competing distilleries were combined and all but seventeen were shut down. These seventeen continued to produce as great a supply as the market demanded. Familiar examples of an excessive number of competitors are found in the case of milk delivery and of the delivery of store products to consumers.[19] The figures quoted on page 515 from the study of grocery costs made by the Wisconsin Experiment Station likewise show that the smallest stores operate at a higher cost than do the stores of medium size. As was shown in previous chapters, the results of such excessive competition are a great duplication of plant and equipment, an excess of overhead expense, and unnecessarily large stocks of merchandise. In addition to these evils is the cost of demand creation which results from the efforts of each competitor to obtain a sufficient part of the available demand to enable him to continue in business, or to utilize an existing plant capacity to the fullest extent, or to make it possible to increase his volume of sales—often with a view to reducing costs of production, costs of selling, or both.

We have seen that the greatest cost of marketing consumption goods is usually found in the final link of the chain of distribution, namely, the retailer. It is in retailing, likewise, that by far the greatest number of competing middlemen are found, and that the smallest volume of business is performed by individual dealers. It is here then that this evil is found

[18] See p. 290.

[19] See also *The Glass Industry*, U. S. Bureau of Foreign and Domestic Commerce, Miscellaneous Series, No. 60 (1917).

in its most acute form. Is it possible and desirable to eliminate some of this "excessive" number of retail dealers?

Meaning of the Term "Too Many Stores."—At the outset, the question arises, just what is meant by stating that there may be too many retail stores? If it means that there are too many independent owners, then the chain store, large coöperative societies, department stores, and large mail order retailers may be the answer. If it means that there are too many individual store units, regardless of ownership, another problem presents itself. It is in this latter form that the question does arise although the economies which may be derived from the central control exercised by chain stores over the local units make so definite a declaration of the problem impossible. Stating it more precisely, are there too many stores to achieve the best service for the price that is paid?[20]

Relation of Number of Stores to Volume of Business.—In the course of coming to a conclusion on this point, consideration should not be given primarily to the number of stores in relation to the population, but to the number of stores in relation to the amount of work performed. That the number of retail stores compared with the total population in the United States is greater in relation to the population to-day than it was in 1850, for example, seems to be unquestionable.[21] But if the increased number of stores is compared with the increased volume of products handled through them, it is found that the average value and volume of goods handled is very much greater now than previously. Although a part of this may be due to the general rise of prices, other causes are important. For it is during this period that many products

[20] See, for example, Chas. P. Steinmetz, *America and the New Epoch* (1916), especially Chap. IV, and E. P. Harris, *Coöperation, the Hope of the Consumer* (1918), pp. 57 ff.

[21] Nystrom shows (*Economics of Retailing* [2d ed.], p. 331) that there were, according to the Census figures, 7.51 merchants (largely retail merchants) to each 1000 of population in 1850; this increased to 11.4 in 1890 and since then has remained relatively constant—at 10.97 in 1900 and 10.92 in 1910.

formerly made in the home have come to be made in manufacturing plants. And during the same period there has been a great increase in the volume of farm products handled through stores, as well as in the consumption of merchandise produced in remote regions. An increased proportion of the population cannot buy directly from producers and do not have their own home manufacture, farms, gardens, etc., to draw from.[22]

More Market Machinery a Result of Modern Methods of Production.—The result of specialization in industry and of the increase in the variety of products the ordinary person consumes has been to increase the amount of distributive work that has to be done. It has been shown that a part of the economies of modern large scale production have been offset by the increased cost of distributing the products produced under these conditions.[23] Moreover, the increased well-being of the American people has made available to them many new products and products from distant places. To distribute these has further increased the amount of market activity necessary in modern society.

It seems, then, returning to retailing, that the increase in the number of stores has not been so great as has the increase in the volume of business they have been called upon to perform. But this does not answer the final question, that there may nevertheless be a larger number of stores than is required to give the best service at the least cost, and that the number may ~~be so large as~~ actually to militate against the acquirement of the best service at the least cost. In a period in which large scale methods of production and large scale retailing have been developing, is the tendency for small retail stores to hold the field in great numbers a cause for inefficient and costly retail service?

Excessive Costs of Retailing Not all Borne by the Imme-

[22] For a statistical study, the reader is again referred to Nystrom, *op. cit.*, pp. 333 ff.

[23] See pp. 503–504.

diate Consumer.—First of all it is by no means certain that the excessive costs of retailing are entirely borne by the immediate consumer, at least in the first instance. Thus, Nystrom has pointed out [24] that although but 10 to 20 per cent of those who start stores are able to continue in business, and an even smaller number truly succeed, the great majority of those who start do not fail in the sense that they bring loss to their creditors. Rather, they fail in the sense that the proprietors see the original capital with which they entered business diminishing and withdraw, without their own capital, but before their creditors suffer. Even so, this is expensive; although it is the method by which the fit are separated from the unfit in a competitive society. Again, it is not at all evident that large scale retailing is more efficient in so far as the costs of operation are concerned. In fact, the costs of selling of department stores and large stores generally, with the possible exception of chain stores, are thought to be greater than the costs of small competing stores when efficiently operated.[25] In other words, there is some reason to believe that retailing reaches a condition of diminishing returns after a certain indefinite point, as the size of the establishment increases.[26]

Advantages of Small Store to Consumer.—Much can be said for the small retail store as a service of convenience to consumers, which must be considered as an offset to their operating inefficiencies. Whereas the large store is usually at some distance, the small store can be close at hand for quick purchases and rapid service, and so performs a very real service and one worth paying for. When we consider that it is doubtful whether the public does have to pay much, if any, more than it would if there were fewer, and consequently,

[24] Nystrom, *op. cit.*, Chap. XVIII.

[25] See Chap. XII.

[26] Nourse (*The Chicago Produce Market*, pp. 114-115) raises the same point in connection with the jobbing of produce, and figures were quoted, *supra*, pp. 150, 152, to show that this is likewise true of jobbers handling staple manufactured products.

larger stores, it evidently may be questioned whether a decrease in the number of stores would be of great benefit to the public. Although this cost must be borne by society in the long run, it must be remembered that it is the price which we pay for the "benefits" of competition.

Question of the Economies of Large Retail Stores.—If there were very great economies in large scale retailing, it would seem that the large store would long since have eliminated its smaller competitor, as large factories have superseded smaller ones in some fields of manufacture. But this has not occurred in any sensible degree. An exception to this may be the recent rapid growth of the chain store which combines the advantages of the small store, from the point of view of service and store cost, with the advantages of more efficient central administration and the purchasing advantages of the large store. If the larger store becomes more efficient, it is likely that we may expect to see it supersede small stores. Competition in retailing is very keen and it seems that although inefficiency is great and the death rate among retailers is large, the persistence of successful small stores indicates that they perform these services at a cost which is satisfactory to the consumer, at least in relation to large store service and costs. If this is true, it appears that the results of inefficiency can be best met by education in business methods rather than through steps to curtail the number of retail stores.[27]

It would seem that similar arguments can be employed in the case of other classes of middlemen generally.[28] In wholesale selling, however, units are larger and the degree of efficiency is greater, because the range of services performed is smaller. Buyers are more skilled and purchase in large

[27] Some suggestions for limiting the number of retailers are discussed in Nystrom, *op. cit.*, Chaps. XIX-XXI.

[28] For discussion of this point in the agricultural wholesale trade, see Weld, *op. cit.*, Chaps. IV-VIII; the *Report of the Federal Trade Commission on the Canned Food Industry;* and see A. W. Shaw Co., ***How to Run a Wholesale Business at a Profit.***

amounts, and price is more important in meeting competition.[29] Efficiency is, consequently, more quickly sensed by the customers, and failure comes more rapidly to the inefficient.

The other aspect of the middlemen problem—the number of successive middlemen involved—has been previously discussed, and it is unnecessary to pursue the question further at this point.[30]

"Profiteering" Not Confined to Middlemen.—A common charge against middlemen is that they make too large a profit. But as a general rule when enormous profits are made by middlemen they do not arise out of the middleman's service as such, but out of general conditions in the market. For example, success in holding goods for a high price is due to the limitation or supposed limitation of supply during a rising market, or a condition of greater or less monopoly control. These situations are probably as often taken advantage of by the producer as by the middleman. Indeed there is a greater incentive for the producer to do so, for his profit depends upon his receiving a high price for his product, whereas the profit of the middleman ordinarily depends upon his accomplishing a large number of exchanges, for himself or his clients.[31]

It seems, then, that the real problems of market price as affected by the operations of middlemen do not arise out of the fact that middlemen exist, but out of the fact that supplies are often limited or, from the point of view of the producer, that demand is limited or supply is too great. The problem may also arise from inefficiency, which is not an evil confined to middlemen alone; and from the lack of adequate market information, which affects equally all parties to the market.

IV

Some Evils of Competition: (1) Excessive Costs.—Some of the wasteful practices which arise under the competitive

[29] See pp. 438–439.
[30] See Chap. XIV.
[31] See the discussion of turnover in Chap. XI.

system may now be summarized. The difficulty of distributing products, which cannot be graded in such a way that unskilled or busy buyers can readily determine their worth, makes necessary and possible enormous sales expense on the part of vendors. This sort of effort involves trying to make consumers realize that "my flour is really better than Smith's flour," while Smith and Jones and Brown are all trying to create the same belief about their flour. There may really be no difference, or such differences as there are may not be reflected in the variations in price. And in any case, the process is extremely expensive. Since the ultimate consumer has no very definite way of determining values the competing manufacturers or dealers, or both, endeavor to make him think as they wish him to. All of them are trying at great cost to make him believe certain things about their product which he finds difficult to verify. For if they could be easily proved, much modern sales effort would not pay because it could do no more than announce the goods—the consumer would judge the quality without assistance from the vendor.

(2) **Excessive Stocks.**—Another source of waste is the excessive amount of capital tied up in duplicate stock, both by manufacturers and merchants. Take as an illustration, the grocer. There may be several important grades and brands of certain highly advertised canned goods. As a result of "consumer advertising," one customer asks for one kind, another for another, and so on. For the customer who does not seem influenced by advertising, the grocer may have another brand which he prefers to sell. Yet he must keep a stock of all, for if a customer demands one brand and cannot get it, he is very likely to go where he can—not merely to purchase this brand but all the other goods he buys. That is, to keep his trade, the merchant must keep on hand all of the various brands that his customers demand.[32] To keep enough of one

[32] Advertising against substitution by manufacturers has strengthened this evil by making the consumer feel that the dealer is trying to cheat him when he suggests a substitute. Experience shows, however, that

brand on hand to meet all demands does not necessitate nearly so large a stock, relatively, as it does to carry a sufficient stock of all brands that may be asked for. Twelve cases of one brand may be enough to have on hand. If several brands are sold it is likely that four or five cases of each must be stored, which although a smaller amount of each kind, causes a much larger total supply to be kept. This situation, which is duplicated with many products, influences the jobber as well as the retailer; and individual manufacturers, each producing a relatively smaller part of the total product of a kind than is needed, must keep a relatively large stock on hand to meet possible demands.[33] Needless to say we do not want to have standardization carried to an extreme. But surely, the legitimate desire of the consumer for individuality and variety has been abused as a selling point by competing manufacturers and dealers.

To the costs of excessive plant and equipment for production, administration, and selling must be added excessive plant, equipment, and administration in the field of physical distribution: excessive warehouse facilities, and cross freights in transportation, such as arise when a Chicago manufacturer sells his product in Detroit or New York and similar products manufactured in Detroit and New York are sold in Chicago.[34]

(3) **Competition and Quality.**—Quality is not guaranteed under the competitive régime. In fact, the individual profit-

the average dealer can, if he desires, easily influence his customers to substitute other products for the advertised products they ask for.

[33] As illustrative of the lack of standardization which is at least partly responsible for this, a recent writer has stated that there are 100 shades of household paint, 518 patterns of piano stool; and a single jobber is said to have had in stock 102 brands of coffee, 30 coffee substitutes, 84 makes of canned beans, 75 kinds of cigars. See Homer Hoyt, *op. cit.* The Colorado Elevator Company has 100 brands of flour. See also p. 138, note 6.

[34] Generally speaking, however, the wastes from cross freights are perhaps not so excessive as they have been pictured, because for many products, in the absence of physical deterioration, transportation costs make up a very small part of the cost of marketing.

seeking at the base of our economic régime which is depended upon to bring this about has a tendency to defeat that very end. Private profit-seeking emphasizes pecuniary profit rather than quality of product or beneficial social results. And it is found that the two are by no means accomplished in the same way at a given time.[35] Even though they tend to be similar in the long run, that result is interfered with through the rapidly changing conditions which are now present in industry and commerce. Partial causes for this are the facts that the range of products has become so broad, the variations of individual products are so great, and standards for determining value vary so much and are so difficult to establish, that in many lines of goods, there are no means by which the consumer can judge of the relative values of competing products.[36]

(4) **Poor Adjustment of Demand and Supply.**—Another evident shortcoming of competition is the frequent failure of "demand and supply" to balance properly. This results, in some cases, simply in a condition of overproduction in a single industry. In other cases, it results in a decline in the demand for large numbers of products at a price which covers the costs of their production. This last condition is a basic cause for our recurring economic crises.[37]

V

Many of the problems which arise in marketing indicate weak points in our existing economic régime. The strength of this system and its weaknesses were summarized in Chapter XXIV. At this point some of the more commonly proposed remedies for the wastes of competition will be briefly reviewed.

(1) **Socialism.**—Among the more common proposals is so-

[35] See W. C. Mitchell, *Business Cycles*, Chap. II.

[36] See Chap. XIX.

[37] The fundamental need for the proper collection, interpretation, and dispersion of market news as an assistance in solving such problems was discussed in Chap. XVIII.

cialism, as variously advocated in many forms and with varied purposes. It is said that socialism will eliminate wasteful competition and order both production and marketing more closely to the general needs of society. Various plans are offered but in so far as they relate to the elimination of the wastes of competition, they advocate some means for the social control of industry, the purpose of which will be to manage it in such a way that demand and supply will be more closely related, and purely competitive selling costs will be eliminated. The arguments for and against socialism are familiar. In their relation to marketing they center largely about the question of the relative social efficiency of the competitive system and a socialistic régime. It is a question of the relative effectiveness of a system which, despite its wastefulness, leads in the long run to improved methods, and so offsets the excessive costs of competition, and the effectiveness of a socialistic society which may be able to eliminate excessive costs of marketing under an existing technical standard, but which it is feared would also result in stagnation and a failure to progress.[38] In other words, as between our present method of control and socialistic control, it appears to be necessary to make a choice between a wasteful progress or an economical stagnation.[39]

(2) Coöperation.—Another important system, which, it is claimed, has already brought about important improvements in marketing, is coöperation by consumer and producer respectively. The enormous growth of consumer coöperation in Europe and England and of producer coöperation among farmers both in this country and abroad is accepted

[38] The Russian experience is uppermost in the public mind at the present time. But while it shows many of the pitfalls of socialized industry the Russian conditions are fundamentally so different from those in Western Europe and America that analogies can hardly be drawn.

[39] For a fuller discussion of these questions, the reader is referred to such discussions as O. D. Skelton, *Socialism* (1911); Edmond Kelly, *Twentieth Century Socialism* (1911); Morris Hillquit, *Socialism in Theory and Practice* (1910); and John Spargo, *Applied Socialism* (1912).

as an indication that these systems of marketing have proved beneficial to those directly interested. Really important results have come, although many of the savings have resulted from the curtailment of services ordinarily rendered by private merchandisers to their patrons. These are services which merchandisers have rendered either because they were demanded by customers or because competition forced sellers to offer them in order to gain and keep their trade from competitors. In so far, however, as these services are unnecessary, or are duplicated on a small and inefficient scale, coöperation may cause a real gain, and in so far as the high costs found in creating a demand for products in a competitive market can be eliminated through such systems, there is a further actual benefit.[40] Whether such a system will ever prevail generally and whether, if it does prevail, progress will be stifled, are questions on which much difference of opinion is found. Many people believe that we may well forego some of our so-called "progress," and, by ordering our lives a little more conservatively, perhaps really increase total well-being.[41]

(3) **Public Markets, Parcel Post, and Express.**—Public markets, and the delivery of products by parcel post and express, particularly perishable produce, are being strongly advocated. Public markets at which farmers and consumers meet for exchange will probably prove to be of greater and greater importance as good roads and the use of the motor truck extend the area that can be made available to a given city market. But none of these things can be expected to revolu-

[40] Coöperation was discussed in Chap. XIII. See also S. and B. Webb, *The Consumers' Coöperative Movement* (1921).

[41] In this connection, it is interesting to note that the cure-all of the man of business is often "more production," which in the case of an individual firm, may change to "sell more." "Stuff the patient," seems to be the prevailing remedy; perhaps a limited diet would in the end prove the more sound.

tionize marketing or to affect greatly the cost of products. Large cities and specialized agricultural areas must draw their products from a wide area. A relatively small part of the produce consumed can be grown so close to the community that the grower can afford to bring his produce to a public market.[42] As a usual thing the consumer likewise cannot afford the time it takes to purchase in this manner. Furthermore, with more distant producing areas, these difficulties are intensified.[43]

It is likewise true that great results cannot be expected from direct sales delivered to consumers by means of the parcel post or express service. The advocates of parcel post have emphasized the use to which this system can be put in eliminating middlemen in the farm market and making direct sale possible. But the opportunities are limited. Small sales made by description are necessary and the difficulties are too great and the opportunities for misunderstanding are too many to cause one to anticipate wide use of this method. The parcel post and express are, of course, widely and profitably used in the delivery of goods sold through the usual channels, and a large volume of "mail order" business in manufactured goods is delivered by these services.

(4) Coöperation and Combination among Competitors.—Another type of coöperation among producers which many believe will eliminate excessive costs of competition is the development toward combination in the so-called "trust movement,"[44] and, more recently, the "open price association."

[42] And even when growers can haul their goods to a city, they may prefer to sell to merchants. See pp. 47–54. In many of our public markets the vendors are retailers and not farmers. In other markets the farmers sell largely to retailers. See the *Report of the Federal Trade Commission on the Wholesale Marketing of Food* (1920), pp. 48–49, 59–60.

[43] See L. D. H. Weld, *The Marketing of Farm Products*, Chap. XVIII.

[44] See Charles P. Steinmetz, *America and the New Epoch* (1916).

The methods and purposes of the trusts as related to marketing are generally familiar.[45] The methods used by such combinations would bring much the same result as would those advocated by many socialists. The outstanding difference is in the means of control. In fact, certain groups of socialists favor the apparent trend toward combination and monopoly on the ground that private enterprise is doing the very thing that the socialists desire. Their policy is to let private enterprises eliminate excessive competition and develop monopolies, and then when the process is complete, to have the state step in and take them over.[46]

One of the strongest arguments in favor of such combinations, and of open price associations, is that what has come to be called "cut-throat" competition is thereby eliminated, to the benefit of society and of the individual firms involved. But combinations in so far as they prove to be monopolistic—and they are not fully successful in controlling competition unless they do approach monopoly—exercise an influence in the market which past experience with them has shown to be harmful. It is essential to the public interest that they be adequately controlled; otherwise society is better off to have them destroyed. Because this attitude has prevailed among our legislators and the judiciary, combinations have been forced to fight for legal existence. There is, however, a growing feeling that perhaps after all it might be best to favor such combinations as can prove themselves economically beneficial and to regulate their activities through government agencies.[47] There could thus be combined to some degree, the

[45] See for example, L. H. Haney, *Business Organization and Combination* (1914), J. W. Jenks, *The Trust Problem* (1907), R. T. Ely, *Monopolies and Trusts* (1900), G. H. Montague, *Trusts of Today* (1904), W. M. Collier, *The Trusts* (1900), and John Spargo, *op cit.*

[46] See, for example, Edmond Kelly, *Twentieth Century Socialism* (1911), pp. 260, 416, 428.

[47] The passage of the Webb-Pomerene Act legalizing combinations in export trade supervised by the Federal Trade Commission, seems to be a step in this direction.

advantages of individual enterprises which are felt to be so important to the success of the competitive régime, with the elimination of waste which some advocates of state activity believe would result from the adoption of their system.

Conclusion.—Some final suggestions can now be made. The marketing process is very expensive. In the case of consumption goods it probably amounts to 50 per cent or more of the price paid by the consumer. Furthermore, the few facts at hand show that there are wide variations in the expenses of competing firms, particularly in the retail field. Such data as are at hand indicate that for many retailers there is great opportunity for improvement. Valuable work is now being done by educational institutions, manufacturers, jobbers, and by retail associations in educating retailers to better methods. The larger market organizations seem to be operating more effectively, but the data for comparison are meagre. It is evident that what is needed is to continue with, and to develop, the work of the various agencies, public and private, which are directed toward discovering the problems of, and improving the methods of, merchandising. So expensive a part of our industrial mechanism as the marketing machinery requires careful study. But it is an intricate and delicate mechanism, and change should develop only from investigation and experience. The selfish interests of those most directly involved may be expected to do much to improve the technique of individual types of operation. But even though one may not favor such drastic proposals as socialism, combination, or even coöperation, it seems, nevertheless, that governmental action and the coöperation of business men will continue to be essential tools ~~in the~~ development of a proper functioning between competing firms and ~~between different~~ societies, as well as a protection ~~for the~~ public from the evil results of extreme competition and of monopoly.

Prof. [illegible] suggestion? Good. Summer Session '16
no kidding.

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